CLERK'S COPY.

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, ~~1929~~ 1930

No. ~~536~~ 82

L. M. WILLCUTS, AS COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MINNESOTA, PETITIONER

vs.

CHARLES W. BUNN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR CERTIORARI FILED DECEMBER 23, 1929
CERTIORARI GRANTED JANUARY 27, 1930

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929

No. 535

L. M. WILLCUTS, AS COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MINNESOTA, PETITIONER

vs.

CHARLES W. BUNN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

INDEX

	Original	Print
Record from D. C. U. S., District of Minnesota	1	1
Caption	1	1
Complaint	1	1
Demurrer to complaint	3	3
Order overruling demurrer to complaint	4	4
Opinion, Cant, J	4	4
Order for entry of judgment	7	7
Judgment	7	7
Notice for appeal	8	8
Assignment of errors	9	8
Petition for appeal	10	10
Order allowing appeal	10	10
Præcipe for transcript	11	11
Election as to printing of record	11	11
Citation and admission of service	12	12
Clerk's certificate to transcript	12	12
Proceedings in U. S. C. C. A., Eighth Circuit	14	15
Appearances of counsel (omitted in printing)	14	15
Argument and submission (omitted in printing)	15	15
Opinion, Stone, J	16	15
Judgment	19	17
Motion for stay of mandate	20	17
Order staying mandate	21	18
Clerk's certificate (omitted in printing)	22	18
Order allowing certiorari	23	18

Pleas and proceedings in the United States Circuit Court of Appeals for the Eighth Circuit, at the May Term, 1929, of said court, before the honorable Kimbrough Stone, the honorable Wilbur F. Booth, and the honorable Archibald K. Gardner, Circuit Judges.

Attest:

[SEAL.] E. E. KOCH,
Clerk of the United States Circuit Court of Appeals for the Eighth Circuit.

Be it remembered that heretofore, to wit, on the twenty-fifth day of March, A. D. 1929, a transcript of record pursuant to an appeal allowed by the District Court of the United States for the District of Minnesota was filed in the office of the clerk of the United States Circuit Court of Appeals for the Eighth Circuit in a certain cause wherein L. M. Willcuts, as collector of internal revenue for the district of Minnesota, was appellant and Charles W. Bunn was appellee, which said transcript as prepared and printed under the rules of the United States Circuit Court of Appeals for the Eighth Circuit, under the supervision of its clerk, is in the words and figures following, to wit:

1 United States District Court, District of Minnesota, Third Division.

Charles W. Bunn, Plaintiff,
No. 1872 vs. Law.
L. M. Willcuts, as Collector of Internal Revenue for the District of Minnesota, Defendant.

Pleas before the Honorable, the Judges of the United States District Court for the District of Minnesota.

Be It Remembered, that on the 19th day of July, 1928, there was filed in said Court in said action a complaint in the words and figures following, to-wit:

2 Complaint.

United States District Court, District of Minnesota, Third Division.

Charles W. Bunn, Plaintiff,
No. .... vs. At Law.
L. M. Willcuts, as Collector of Internal Revenue for the District of Minnesota, Defendant.

Plaintiff complains of the defendant above named and alleges:

I.

That this is a case arising under a law providing for internal revenue, to-wit; under the Revenue Act of 1924. That the defendant is and at the dates herein mentioned was the duly appointed and acting Collector of Internal Revenue for the District of Minnesota.

II.

That the plaintiff resides in Minnesota and was in receipt of taxable income in the year 1924. That he punctually made full return of said taxable income to the defendant, and punctually paid the tax payable thereon. Thereafter, under date of February 17, 1928, the Commissioner of Internal Revenue, upon review of said return, purported to determine that

there was due from the plaintiff additional income tax for the year 1924 in the sum of Eighty-five and 44/100 Dollars ($85.44), for which amount, with interest in the sum of
3 Fourteen and 07/100 Dollars ($14.07), amounting together to the sum of Ninety-nine and 51/100 Dollars, ($99.51) the defendant made demand upon the plaintiff on or about May 4, 1928.

III.

That the facts giving rise to said purported determination of additional tax and demand for payment are as follows:

At various dates in the years 1919 and 1920 the plaintiff purchased for cash, as investments, certain bonds issued by various counties and cities in the State of Minnesota. In the month of January 1924 the plaintiff sold all of the said bonds, and realized upon the whole transaction a net profit (disregarding interest accrued on coupons) of Seven Hundred Thirty-six and 26/100 Dollars ($736.26). Upon this net profit (less a net loss of Forty-one and 20/100 Dollars ($41.20) suffered by plaintiff on certain similar bonds held less than two years) the Commissioner of Internal Revenue determined and the defendant demanded payment of additional income tax in the amount above alleged. The facts found by the Commissioner are true, his arithmetical calculations are correct, and the amount of additional tax determined and demanded is correct if the said profit derived as aforesaid is lawfully taxable as income.

IV.

On May 8, 1928, plaintiff paid to the defendant, under duress and protest, the said additional tax demanded, with interest, totalling Ninety-nine and 51/100 Dollars ($99.51). Thereupon plaintiff duly filed with the Commissioner of Internal Revenue a claim for refund of said additional tax, according to the provisions of law in that regard and the regulations of the Secretary of the Treasury established in pursuance thereof. The basis of said claim for refund, as therein stated, was that: "The tax was illegal because assessed in income from municipal bonds issued by political subdivisions of states." Upon June 19, 1928, the Commissioner of Internal Revenue rejected the said claim and so advised the plaintiff.
4

V.

The said additional tax was illegal for the reason stated in said claims for refund; and the Revenue Act of 1924,

if construed and applied to tax the said income so received by plaintiff by way of profit on the sale of said municipal securities, is in fact a tax upon the instrumentalities of states and is unconstitutional and void for that reason.

Wherefore plaintiff demands judgment against defendant in the sum of Ninety-nine and 51/100 Dollars ($99.51), with interest at six per cent (6%) per annum from May 8, 1928, together with his costs and disbursements in this action.

DOHERTY, RUMBLE,
BUNN & BUTLER,
Attorneys for Plaintiff,
1006 Merchants National Bank
Bldg., Saint Paul, Minnesota.

5 State of Minnesota,
County of Ramsey—ss.

Charles W. Bunn, being first duly sworn, deposes and says that he is the plaintiff in the above entitled action; that he has read the foregoing complaint and knows the contents thereof; that the same is true, except as to the matters therein stated on information and belief, and as to those matters he believes it to be true.

CHARLES W. BUNN,

Subscribed and sworn to before me this 19th day of July, 1928.

EDWIN IRLE.

(Notarial Seal)

Notary Public, Hennepin County, Minn.

My commission expires Nov. 28, 1929.

(Endorsed) Complaint Filed July 19, 1928, Joel M. Dickey, Clerk.

---

6 (Demurrer to Complaint.)

Now comes the defendant in the above entitled action and demurs to the plaintiffs complaint herein for the reason that said complaint does not state facts sufficient to constitute a cause of action.

LEWIS L. DRILL,
Attorney for the Defendant &
United States Attorney.

(Endorsed): Demurrer. Filed August 15, 1928, Joel M. Dickey, Clerk.

---

7 (Order Overruling Demurrer to Complaint.)

United States District Court, District of Minnesota, Third Division.

Charles W. Bunn, Plaintiff,

vs.

L. M. Willcuts, as Collector of Internal Revenue for the District of Minnesota, Defendant.

The defendant having interposed a demurrer to plaintiff's complaint herein, on the ground that said complaint does not state facts sufficient to constitute a cause of action, the matter came on regularly for hearing before the court, Mr. Lewis L. Drill, United States Attorney, and Mr. Martin W. Goldsworthy, Special Attorney, Buerau of Internal Revenue, appearing for the defendant in support of said demurrer, and Mr. Chas. Bunn appearing for the plaintiff in opposition thereto. The court having heard and considered the arguments of counsel, and being now fully advised in the premises,

It Is Ordered that said demurrer be and the same hereby is overruled.

Dated November 17, 1928.

By the Court

WM. A. CANT,
United States District Judge.

Memorandum.

Plaintiff purchased certain bonds issued by municipal corporations of the State of Minnesota, and thereafter sold such bonds at a profit. Under the Revenue law of United States, the government levied a tax on the profit so realized by plaintiff, and, under protest, plaintiff paid such tax. He has brought this action to recover the amount so paid. Defendant has interposed a demurrer to plaintiff's complaint
8 on the ground that the same does not set forth facts sufficient to constitute a cause of action. The question for determination is whether gains or profits of the character here in question are subject to such tax.

The means and instrumentalities of a state government are exempt from taxation by the United States. The Collector vs. Day, 11 Wallace, 113, 1927. This principle is not based upon any constitutional provision. It rests on necessary

implication. Id. The rule extends to obligations issued by the State, or by any political subdivision thereof. Pollock vs. Farmers' Loan & Trust Co., 157 U. S., 429, 583, et seq. It also covers income arising from such obligations. Id. Pp. 583, 585, 586. Metcalf & Eddy vs. Mitchell, 269 U. S. 514, 522. The rule does not rest upon the language of the statute quoted at page 585 of the Pollock case, but upon general principles of law. Pp. 585, 586, Pollock case.

The broad terms of the Sixteenth Amendment, under which the tax in question was imposed, did not extend the taxing power of the United States to new subjects. In that behalf, the earlier rules above stated still prevail. Evans vs. Gore, 253 U. S., 245.

It is, therefore, beyond dispute that income from bonds such as those here in question, is not subject to a tax under the Revenue law. Limited still further, the question here is whether gains and profits realized on the sale of such bonds, are income within the meaning of the law.

Confessedly, the tax here in question was a tax on income. Otherwise, there would be no jurisdiction for its levy. Clearly that income was derived from municipal bonds issued under the authority of the State of Minnesota.

In such cases the underlying principle is that the Federal Government shall not exercise the power of taxation in such manner as in any substantial degree to interfere with the State in any of its governmental functions. In the performance of such functions, the State and its various subdivisions require money. They often borrow. In such cases bonds or other obligations are issued and are offered for sale to the investing public. A tax on such obligations, or on the income therefrom, is a burden thereon and makes them less desirable and less salable in the market. It interferes with the demand for such obligations and with the success of the State or other political subdivision in raising money through their sale. Under the principle hereinbefore stated, no such tax is valid.

In like manner, if at the time that any issue of State or municipal bonds is offered to the investing public, it shall be known that any gain or profit realized from a rise in value of such bonds, and a sale thereof would be subject to a Federal tax, which might be increased at any time, this circumstance would operate to discourage the public from dealing in such securities, and would cause a reduction in the price which purchasers would be willing to pay therefor.

The imposition of such a tax, therefore, would affect the power of the State or municipality to borrow money and also the amount which could be realized from the sale of its securities. This would be an unjustifiable interference with the financial operations of the governmental subdivision in question, and, equally wth a tax directly imposed on the bonds themselves, and for substantially the same reasons, should be held invalid.

9 Unless expressly prohibited by law, the State may impose a tax on its own outstanding obligations. The Federal government may impose a tax on obligations issued under its authority. Neither may impose a tax on obligations issued by the other.

The following language of Chief Justice Marshall, in Weston vs. City Council of Charleston, 2 Peters, 449, 468, applies:

"The right to tax the contract to any extent, when made, must operate upon the power to borrow, before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government; to any extent, however inconsiderable, it is a burden on the operations of government. It may be carried to an extent which shall arrest them entirely."

This language is quoted in Pollock vs. Farmers' Loan & Trust Co., 157 P. S. 429, 586, and is followed by a statement reading as follows:

"Applying this language to these municipal securities, it is obvious that taxation on the interest therefrom would operate on the power to borrow before it is exercised, and would have a sensible influence on the contract, and that the tax in question is a tax on the power of the States and their instrumentalities to borrow money, and consequently repugnant to the Constitution."

In such cases, it is an advantage to the purchaser and to the governmental subdivision which issues such securities, that such purchaser shall be permitted to acquire the securities free from the possibility that any tax will be imposed on the obligation or on the proceeds thereof. That advantage is important. Any interference therewith affects the State or other governmental subdivision adversely, and in a substantial degree, in the exercise of its governmental functions, and such was the effect of the tax here in question

Upon either of two separate grounds the tax here involved should be held invalid:

1. Because the gain or profit on which the tax was levied, was income arising from the bonds here in question and was beyond the power of the government to tax.

2. Because, whether such gain or profit be regarded as income strictly so called, or not, the levy of a tax thereon was and is within the reason of the rule which forbids a tax on the securities in question, or on the interest arising therefrom.

The tax was either a tax on the bonds themselves, or a tax on the income arising therefrom. On its face it was the latter. In either case it was invalid.

The complainant states a cause of action and the demurrer should be overruled.

Dated November 17, 1928.

WM. A. CANT,
United States District Judge.

(Endorsed): Order and Memorandum. Filed November 19, 1928. Joel M. Dickey, Clerk, By Margaret L. Mullane, Deputy.

---

10 (Judgment, March 8, 1929.)

In the District Court of the United States in and for the District of Minnesota, Third Division.

Term Minutes.

November Term, A. D. 1928.

March 8, 1929.

Friday morning.

Court opened pursuant to adjournment.

Present: Honorable William A. Cant, Judge.

United States District Court, District of Minnesota, Third Division.

Charles W. Bunn, Plaintiff,
vs.
L. M. Willcuts, as Collector of Internal Revenue for the District of Minnesota, Defendant.

Order for Judgment.

The defendant in the above entitled cause having interposed a demurrer of the complaint, and the same having

been heard and overruled by the Court, and the defendant having declined to plead further, it is now, on motion of the plaintiff,

Ordered that judgment be entered in favor of the plaintiff and against the defendant in the amount claimed in the complaint, with interest to the date of said judgment at the rate of six per cent, and with the plaintiff's actual disbursements to the marshal for service of summons and to the clerk for clerk's fees, but without any other costs.

Dated March 5, 1929.

WM. A. CANT
United States District Judge.

Wherefore, in accordance with said order for judgment, it is by the Court

Considered, Ordered and Adjudged: that the plaintiff herein, Charles W. Bunn, do have and recover of and from the defendant herein, L. M. Willcuts, as Collector of Internal Revenue for the District of Minnesota, the sum of ninety-nine and 51/100 dollars ($99.51), together with interest thereon at the rate of six per cent (6%) per annum from
11 May 8, 1928, amounting to the sum of three and 95/100 dollars ($3.95), together with costs and disbursements herein taxed at the sum of twelve and 06/100 dollars ($12.06), and amounting in all to the sum of one hundred fifteen and 52/100 dollars ($115.52).

---

12 Notice of Appeal.

To the above-named plaintiff, and to Doherty, Rumble, Bunn & Butler, his attorneys:

Please take notice that the above-named defendant, L. M. Willcuts, conceiving himself aggrieved by the judgment made, entered and docketed herein on the 8th day of March, 1929, in the above-entitled court, does hereby appeal from said judgment to the United States Circuit Court of Appeals for the Eighth Circuit, for the reasons specified in Defendant's Assignment of Errors, made and filed herein and a copy of which is herewith served upon you.

Dated March 14, 1929.

LEWIS L. DRILL
United States Attorney and
Attorney for Defendant.

---

13 Assignment of Errors.

L. M. Willcuts, defendant in the above entitled cause, makes the following assignment of errors which he avers were committed by the Court in the rendition of the judgment against this defendant appearing upon the record herein, that is to say:

First. The Court erred in overruling the demurrer interposed by the defendant and in holding and deciding that the complaint filed herein by the plaintiff stated facts sufficient to constitute a cause of action.

Second. The Court erred in rendering judgment for the plaintiff.

Third. The Court erred in holding and deciding that the gain or profit derived from the sale of bonds or securities issued by various political subdivisions of the State of Minnesota, was not subject to Federal taxation.

Fourth. The Court erred in holding and deciding that the income sought to be taxed was "income arising from the bonds here in question."

Fifth. The Court erred in holding and deciding that Federal taxation of income arising from the sale of municipal bonds or securities before maturity, was an unwarranted interference in the governmental functions of a political subdivision of a State, and a burden upon its power to borrow money.

14 Wherefore defendant prays that the said judgment may be reversed.

Dated March 13, 1929.

L. M. WILLCUTS,
Collector of Internal Revenue for the District of Minnesota, defendant.

LEWIS L. DRILL,
United States Attorney and attorney for the defendant.

Due service of the within Notice of Appeal and Assignment of Error is hereby admitted this 14th day of March, 1929.

DOHERTY, RUMBLE, BUNN & BUTLER,
Attorneys for Plaintiff.

(Endorsed): Notice of Appeal and Assignments of Error. Filed Mar. 20, 1929, Joel M. Dickey, Clerk, by Alice M. Mulrennan, Deputy.

---

15 Petition for Writ of Appeal.

The petitioner, L. M. Willcuts, Collector of Internal Revenue for the District of Minnesota, by his attorney, Lewis L. Drill, United States Attorney for the District of Minnesota, feeling aggrieved by the Judgment entered on the 8th day of March, 1929, by this Court and the Order overruling the demurrer filed herein by the defendant, does hereby appeal from said Order and Judgment of this Court in the United States Circuit Court of Appeals for the Eighth Circuit under the laws of the United States in such case made and provided.

Wherefore your petitioner further prays that an appeal in this behalf in the United States Circuit Court of Appeals aforesaid sitting at St. Louis in said Circuit for the correction of the errors complained of and herewith assigned may be allowed, and that a transcript of the record of proceedings and papers upon which the said Order and Judgment was made, duly authenticated, may be sent to the United States Circuit Court of Appeals for the Eighth Circuit.

Dated St. Paul, Minnesota, March 19, 1929.

LEWIS L. DRILL,
United States Attorney and Attorney for Defendant.

---

16 Order Allowing Appeal.

On reading the petition of L. M. Willcuts, made on his behalf by Lewis L. Drill, United States Attorney, dated March 19, 1929, for appeal and consideration of the assignment of errors presented therewith, it is

Ordered, that the appeal herein be allowed as prayed for, and it is further

Ordered, that a certified transcript of the record and all proceedings be transmitted to the Circuit Court of Appeals for the Eighth Circuit.

Dated Minneapolis, Minnesota, March 19, 1929.

WM. A. CANT,
United States District Judge.

(Endorsed): Order Allowing Appeal, Filed Mar. 20, 1929, Joel M. Dickey, Clerk, by Alice M. Mulrennan, Deputy.

---

17 Praecipe for Transcript.

To Joel M. Dickey, Clerk of above entitled Court:

You will please prepare transcript of the record in this cause, to be filed in the office of the Clerk of the United States Circuit Court of Appeals for the Eighth Judicial Circuit, under the appeal heretofore perfected to said Court, and include in said transcript the following pleading, proceedings, and papers on file, to-wit: Complaint, Demurrer to Complaint, Order Overruling Demurrer and Memorandum Opinion, Order for Judgment, Judgment, Petition for Writ of Appeal, Order Allowing Appeal, Notice of Appeals, Assignment of Errors, Citation, and this Praecipe.

Said transcript to be prepared as required by the rules of this Court and the United States Circuit Court of Appeals for the Eighth Circuit; and to be on file at the City of St. Louis, Missouri, on or before April 1, 1929.

LEWIS L. DRILL,
United States Attorney and Attorney for Appellant.

Appellee hereby agrees that the foregoing within mentioned pleadings, proceedings and papers shall be and constitute the transcript and record as on appeal herein.

DOHERTY, RUMBLE, BUNN & BUTLER,
Attorneys for Appellee.

(Endorsed): Praecipe for Transcript, Filed Mar. 20, 1929, Joel M. Dickey, Clerk, by Alice M. Mulrennan, Deputy.

---

18 (Election as to Printing of Record.)

Appellant in the foregoing entitled action hereby gives notice of his election to take and file in the Appellate Court, to be printed under the supervision of its Clerk under its rules, the transcript of the record on appeal herein.

Dated March 14, 1929.

LEWIS L. DRILL,
United States Attorney and Attorney for Appellant.

(Endorsed): Notice of Election, filed Mar. 20, 1929, Joel M. Dickey, Clerk, by Alice M. Mulrennan, Deputy.

---

19 Citation.

United States District Court, District of Minnesota, Third Division.

Charles W. Bunn, Plaintiff,
No. 1872. vs. At Law.
L. M. Willcuts, as Collector of Internal Revenue for the District of Minnesota, Defendant.

United States of America, To Charles W. Bunn—Greeting:

You are hereby cited and admonished to be and appear in the United States Circuit Court of Appeals for the Eighth Circuit, at the City of St. Louis, Missouri, thirty days from and after the day this citation bears date pursuant to a Notice of Appeal filed in the Clerk's Office of the District Court of the United States for the District of Minnesota, Third Division, wherein L. M. Willcuts is appellant, and you are Appellee; to show cause, if any there be, why the judgment rendered against the said appellant, as in said Notice of Appeal mentioned, should not be reversed, and why speedy justice should not be done the parties in that behalf.

Witness, the Honorable William A. Cant, one of the Judges of said Court this 19th day of March, A. D. 1929.

WM. A. CANT,
District Judge.

Due service of the within Citation is hereby admitted this 20th day of March, 1929.

DOHERTY, RUMBLE, BUNN & BUTLER,
Attorneys for Plaintiff.

Endorsed: Filed in U. S. District Court on March 20, 1929.

---

21 (Clerk's Certificate to Transcript.)

United States District Court, District of Minnesota, Third Division.

I, Joel M. Dickey, Clerk of said District Court, do hereby certify and return to the Honorable, the United States Circuit Court of Appeals for the Eighth Circuit, that the fore-

going, consisting of twenty-one pages, numbered consecutively from 1 to 21, inclusive, is a true and complete transcript of the records, pleadings, orders, final judgment and other proceedings in the case of Charles W. Bunn, plaintiff, vs. L. M. Willcuts, as Collector of Internal Revenue for the District of Minnesota, defendant, as appears from the original records and files of said Court and in accordance with a praecipe for such transcript, a copy of which is included in said transcript; and I do further certify and return that I have annexed to said transcript and included within said paging the original Citation, together with the admission of service thereof.

In witness whereof, I have hereunto set my hand as the Clerk aforesaid, and affixed the seal of said Court at St. Paul, in said District, this 23rd day of March, 1929.

Seal
U. S. Dist. Court
Dist. of Minnesota
Third Div.

JOEL M. DICKEY, Clerk,
By Margaret L. Mullane,
Chief Deputy.

Filed Mar. 25, 1929. E. E. Koch, Clerk.

14 [Appearances of counsel omitted in printing.]

15 [Minute entry of argument and submission, June 4, 1929, omitted in printing.]

16 In United States Circuit Court of Appeals, Eighth Circuit

No. 8565. May term, A. D. 1929

L. M. WILLCUTS, AS COLLECTOR OF Internal Revenue, etc., appellant vs. CHARLES W. BUNN, APPELLEE	Appeal from the District Court of the United States for the District of Minnesota

Mr. William T. Sabine, jr., special attorney, Bureau of Internal Revenue (Mr. Lewis L. Drill, United States attorney, Mr. C. M. Charest, General Counsel, Bureau of Internal Revenue, Mr. M. W. Goldsworthy, special attorney, Bureau of Internal Revenue, and Mr. T. H. Lewis, jr., special attorney, Bureau of Internal Revenue, were on the brief), for appellant.

Mr. Charles Bunn (Messrs. Doherty, Rumble, Bunn & Butler were with him on the brief) for appellee.

Before STONE, BOOTH, and GARDNER, Circuit Judges

Opinion

Filed September 16, 1929

STONE, Circuit Judge, delivered the opinion of the court.

During 1919 and 1920 appellee purchased, as investments, certain bonds issued by counties or by cities in Minnesota. In January, 1924, he sold these bonds at a net profit (not including accrued interest). A tax was paid (under protest) upon this profit as taxable income of appellee. This action is for refund thereof on the
17 ground that such income is not subject to Federal taxation because derived from municipal securities of a State. This appeal is from a judgment entered against appellant, upon his election to stand upon an overruled demurrer to the petition.

The sole issue is whether profits from sales of municipal securities are subject to Federal taxation.

It is a necessary condition of our dual form of government over the same territory that neither the National nor the State Governments should interfere with the proper functioning of the other. Therefore it has been repeatedly announced that neither the Federal Government nor a State government can constitutionally enact a law which interferes with the proper exercise of the governmental

powers of the other. (Gillespie v. Oklahoma, 257 U. S. 501; Collector v. Day, 11 Wall. 113; McCulloch v. Maryland, 4 Wheat. 316.) This principle has been applied to taxation by either of the securities issued by the other (The Macallen Company v. Massachusetts, — U. S. —; Plummer v' Coler, 178 U. S. 115, 117; Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 583; Home Ins. Co. v. New York, 134 U. S. 594, 598; Mercantile Bank v. New York, 121 U. S. 138; Bank of Commerce v. New York City, 2 Black 620; Weston v. Charleston, 2 Pet. *449), since no governmental function is more important nor necessary than that of raising revenue for its needs by borrowing (Weston v. Charleston, 2 Pet. *449, *465). The above citations have applied the rule to attempts to tax the security as property or the interest derived therefrom as income. While taxation of a privilege where the tax was measured by property or income consisting in whole or part of such securities has been upheld (Greiner v. Lewellyn, 258 U. S. 384; Flint v. Stone Tracy Co., 220 U. S. 107; Home Ins. Co. v. New York, 134 U. S. 594; Hamilton Co. v. Massachusetts, 6 Wall. 632), yet the distinction has been carefully observed "between an attempt to tax the property or income as such and to measure a legitimate tax upon the privileges involved in the use hereof" (The Macallen Co. v. Massachusetts, — U. S. —), and no tax has been sustained where it was levied directly upon such securities or the incomes therefrom.

This tax is a direct tax upon income. That income is derived solely from the municipal securities. Does the circumstance that this income came from sale profit instead of interest prevent
18 application of the rule? The reason for the rule, as applied to such securities, is that such a direct tax is a "burden on loans" and an "impediment to the power of borrowing." (Weston v. Charleston, 2 Pet. *499, *468.) Anything which would usually influence the public in buying or refraining from buying such securities unquestionably is a burden upon such loans and an impediment to such borrowing power. It is a matter of common knowledge that municipal securities are almost always issued for a long term of years. If the original buyers of such from the municipalities were confined to those who expect to hold such until maturity, comparatively few such securities would issue and upon terms not favorable to the municipalities. It is also common knowledge that the interest rate on such securities is usually lower than upon currently issued private securities. Two of the main attractions of such securities are that they are tax free and offer a chance for profit in resale. To say that taxation upon such profit would not affect purchases, and therefore prices, of such securities seems unfounded. It would materially lessen the attractiveness of such securities and thereby affect the borrowing power injuriously. When this detrimental situation is brought about by a direct tax upon such profit as such, the rule relied upon by appellee and announced in the above citations and in other cases is applicable and controlling.

The judgment should be and is affirmed.

19 In United States Circuit Court of Appeals, Eighth Circuit

No. 8565

L. M. WILLCUTS, AS COLLECTOR OF INTERNAL REVENUE FOR THE District of Minnesota, appellant

vs.

CHARLES W. BUNN

Judgment

September 23, 1929

Appeal from the District Court of the United States for the District of Minnesota.

This cause came on to be heard on the transcript of the record from the District Court of the United States for the District of Minnesota and was argued by counsel.

On consideration whereof it is now here ordered and adjudged by this court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed with costs, and that Charles W. Bunn have and recover against L. M. Willcuts, as collector of internal revenue for the District of Minnesota, the sum of twenty-six dollars for his costs herein.

20 In United States Circuit Court of Appeals

Motion for stay of mandate

Filed October 28, 1929

Treasury Department, Bureau of Internal Revenue, Washington

424 POST OFFICE BUILDING, SAINT PAUL MINNESOTA,
MWG OTT *October 14, 1929.*

Hon. KIMBROUGH STONE,
Judge United States Circuit Court
of Appeals, Eighth Circuit,
St. Louis, Missouri.

In re: Willcuts, Collector, v. Charles W. Bunn.

DEAR SIR: Reference is made to the above-entitled case and to a letter received from the General Counsel of the Bureau of Internal Revenue under date of October 7, 1929, a part of which is herewith quoted:

"This case having been decided adversely to the United States, you are requested to see that the mandate is stayed and such other steps taken as are necessary to protect the Government's interests pending receipt of advices from the Attorney General as to whether or not a petition for certiorari will be filed."

Upon receipt of the above-mentioned letter the writer conferred with Judge Booth, who suggested that the matter be referred to you, with a request that the mandate herein be stayed for an additional thirty days beyond the sixty-day period that ordi-
21 narily prevails, for the purpose of allowing the Attorney General sufficient time to determine the advisability of petitioning for a writ of certiorari. Accordingly such request is herewith made.

I would appreciate your notifying me with regard to the above.

Respectfully,

M. W. GOLDSWORTHY,
Special Assistant to the United States Attorney.

[File endorsement omitted.]

In United States Circuit Court of Appeals

Order staying issuance of mandate

October 28, 1929

On consideration of the motion of counsel for appellant it is now here ordered by this court that the issuance of the mandate herein be, and the same is hereby, stayed until December 16, 1929, pending a petition to the Supreme Court of the United States for a writ of certiorari, and if on or before that date there is filed with the clerk of this court a certificate of the clerk of the Supreme Court of the United States that a petition for writ of certiorari, record, and brief have been filed and proof by affidavit of notice thereof under paragraph 3 of rule 38 of the Supreme Court be given, the stay hereby granted shall continue until the final disposition of the case by the Supreme Court.

22 [Clerk's certificate to foregoing transcript omitted in printing.]

23 Supreme Court of the United States

Order allowing certiorari

Filed January 27, 1930

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover:] File No. 34666. U. S. Circuit Court of Appeals, Eighth Circuit. Term No. 535. L. M. Willcutts, as collector of internal revenue for the District of Minnesota, petitioner, vs. Charles W. Bunn. Petition for writ of certiorari and exhibit thereto. Filed December 23, 1929. File No. 34666.

U. S. GOVERNMENT PRINTING OFFICE: 1930

Office Supreme Court, U.
FILED
DEC 23 1929
CHARLES ELMORE CROPLEY
CLERK

FILE COPY

No. ~~585~~ 22

In the Supreme Court of the United States

OCTOBER TERM, 1929

L. M. WILLCUTS, AS COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MINNESOTA, PETITIONER

v.

CHARLES W. BUNN

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

INDEX

	Page
Petition:	
Statement	2
Specification of error to be urged	3
Reasons for granting the writ	3
Brief in support of the petition:	
Opinions below	5
Jurisdiction	5
Question presented	5
Statute involved	5
Statement	6
Argument	7
Conclusion	13
Appendix A: Rulings of the Treasury Department	14
Appendix B: Opinion of the Circuit Court of Appeals, Sixth Circuit, in Charles H. Nauts, Collector, v. W. L. Slayton	15

CITATIONS

Cases:	
Greiner v. *Lewellyn*, 258 U. S. 384	12
Heiner v. *Colonial Trust Co.*, 275 U. S. 232	8
Metcalf & Eddy v. *Mitchell*, 269 U. S. 514	10
National Life Ins. Co. v. *United States*, 277 U. S. 508	9
Nauts v. *Slayton* (C. C. A. 6th), decided December 6, 1929	4, 12
Orr v. *Gilman*, 183 U. S. 278	4, 11
Panhandle Oil Co. v. *Knox*, 277 U. S. 218	10
Plummer v. *Coler*, 178 U. S. 115	4, 9, 11
Statute:	
Revenue Act of 1924, c. 234, Sec. 213 (a), 43 Stat. 253, 267 (U. S. C., Title 26, Sec. 954)	5
Miscellaneous:	
Annual Report of the Secretary of the Treasury for 1921, pp. 680–685	9
Grimes & Craigue, Principles of Valuation, 1928, p. 204	9
O. D. 647, Cumulative Bulletin No. 3, July–December, 1920, p. 123	7, 14
O. D. 737, Cumulative Bulletin No. 3, July–December, 1920, p. 49	7, 14
O. D. 762, Cumulative Bulletin No. 4, January–June, 1921, p. 31	7, 15

87079—29——1

In the Supreme Court of the United States

OCTOBER TERM, 1929

No. ——

L. M. WILLCUTS, AS COLLECTOR OF INTERNAL REVENUE for the District of Minnesota, Petitioner

v.

CHARLES W. BUNN

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General on behalf of L. M. Willcuts, Collector of Internal Revenue for the District of Minnesota, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Eighth Circuit entered in the above case on September 23, 1929 (R. 17), affirming the judgment of the District Court for the District of Minnesota. (R. 7.)

STATEMENT

At various dates in the years 1919 and 1920 the respondent purchased for cash as investments certain bonds issued by various counties and cities in the State of Minnesota. The record does not disclose whether these bonds were purchased from a political subdivision or from some one else, nor does it appear whether the bonds were purchased at, above, or below par. In the month of January, 1924, the respondent sold these bonds and realized upon the whole transaction a net profit (disregarding interest accrued on coupons) of $736.26. He did not include any part of this profit in his income tax return. The Commissioner added this profit (less a net loss of $41.20 suffered by the respondent on certain similar bonds held less than two years) to the respondent's income, and assessed an additional tax of $85.44. This additional tax, together with interest amounting to $14.07, the respondent paid on demand under protest on May 8, 1928. He then filed a claim for refund which was rejected. (R. 2.)

The respondent filed his complaint in the United States District Court for the District of Minnesota (R. 1) and the petitioner demurred. (R. 3.) The District Court overruled the demurrer (R. 4) and, upon failure of the petitioner to answer, entered judgment for the respondent. (R. 8.) From this judgment an appeal was prosecuted to the Circuit

Court of Appeals for the Eighth Circuit, which sustained the lower court. (R. 17.)

SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred in holding that Congress may not constitutionally impose an income tax on gains derived by the owner of municipal bonds from the sale of such bonds at a profit.

REASONS FOR GRANTING THE WRIT

The question whether the Federal Government may constitutionally tax the gain derived from the sale of municipal bonds by an individual is an important one which has not been but should be settled by this Court. The Treasury Department has consistently interpreted the Revenue Acts as imposing an income tax on such gain. In overturning this uniform construction the Circuit Court of Appeals has relied upon decisions of this Court which hold that the Federal Government can not interfere with the exercise by a State of its governmental powers. The facts in the instant case do not involve the exercise by a State of its governmental powers. No attempt is being made to tax the bond itself, nor the interest thereon paid by the State. A tax in such cases would concededly be unconstitutional. Here, the transaction which gives rise to the imposition of the tax is between individuals, and not between an individual and a State or a subdivision thereof.

The possibility of a future conflict of decisions on the question here involved is indicated by the opinion of the Circuit Court of Appeals for the Sixth Circuit in *Nauts* v. *Slayton,* decided December 6, 1929, not yet officially reported (see Appendix B), where, in discussing the instant case, the court said: "Even were we to consider the question [in the *Bunn case*] as not foreclosed by the holdings of the Supreme Court in *Plummer* v. *Coler,* 178 U. S. 115; *Orr* v. *Gilman,* 183 U. S. 278, it is not now before us."

The question involved is far reaching in its application and importance. It equally affects the power of States to impose a similar tax upon profits on sales of United States obligations. The decision of the Circuit Court of Appeals thus affects thousands of taxpayers.

Wherefore, it is respectfully submitted that this petition for certiorari to review the judgment of the Circuit Court of Appeals for the Eighth Circuit should be granted.

CHARLES E. HUGHES, JR.,
Solicitor General.

DECEMBER, 1929.

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the District Court (R. 4) is reported in 29 F. (2d) 132. The opinion of the Circuit Court of Appeals (R. 15) is reported in 35 F. (2d) 29.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on September 23, 1929. (R. 17.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Is the imposition of a tax on gains derived by the owner of municipal bonds from the sale of such bonds at a profit unconstitutional?

STATUTE INVOLVED

Revenue Act of 1924, c. 234, 43 Stat. 253, 267 (U. S. C., Title 26, Sec. 954):

> SEC. 213. For the purposes of this title, except as otherwise provided in section 233—
>
> (a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the Presi-

> dent of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

While the Treasury Department has promulgated no formal regulations with respect to the inclusion in taxable income of a profit derived from the sale of State and municipal bonds, it has consistently ruled that such profits are taxable. The published rulings on the subject are set out in Appendix A.

STATEMENT

The statement of the facts and the error relied upon will be found in the petition.

ARGUMENT

A Federal tax on a State or municipal bond would be invalid. So would a tax on the interest. But a tax on profit derived from the sale of the bond is neither a tax on the bond nor on the interest. It is a tax on the gain from a transaction wholly apart from the contract between the municipality and the lender, and to which the bond is only an incident.

The Treasury Department in its rulings has been meticulous in its care to keep strictly within constitutional limitations by imposing the tax only upon the profit from the sale of State and municipal securities. Those rulings recognize that neither the purchase of the bonds at a discount from the State nor the redemption by the State of its securities at par produces taxable profit. Discount on the original issue by the State merely represents interest in an altered form. It is part of the cost to the State of the money borrowed. In fact, though not in name, it is additional interest. Consequently, the Treasury Department has exempted it from taxation. O. D. 647, 3 C. B. 123; O. D. 737, 3 C. B. 49; O. D. 762, 4 C. B. 31. (See Appendix A.)

For the purpose of this brief, it is not thought necessary to deal with the limitations of the rule as applied to the subsequent sale at a profit of bonds originally issued by the State or municipality at a discount. In the discussion which follows, therefore, we do not use the terms "gain" or "profit" as

including, in cases where the bonds sold were originally issued at a discount, such part of the sum received by the seller as is solely attributable to that fact.

Even if it be conceded that an income tax on the profit from a sale of State securities may have some perceptible economic effect upon the borrowing power, that fact is too narrow a basis upon which to rest the conclusion that the taxation of such profit is beyond the power of Congress. *Heiner* v. *Colonial Trust Co.*, 275 U. S. 232, 235. The Circuit Court of Appeals, in the instant case, however, rests its decision upon that basis. It said (R. 16):

> Anything which would usually influence the public in buying or refraining from buying such securities unquestionably is a burden upon such loans and an impediment to such borrowing power. It is a matter of common knowledge that municipal securities are almost always issued for a long term of years. If the original buyers of such from the municipalities were confined to those who expect to hold such until maturity, comparatively few such securities would issue and upon terms not favorable to the municipalities. It is also common knowledge that the interest rate on such securities is usually lower than upon currently issued private securities. Two of the main attractions of such securities are that they are tax free and offer a chance for profit in resale.

The court thus condemns the tax on the ground that the statute, if applied as written, may pos-

sibly have some perceptible economic effect upon the market for bonds. This seems to be a departure from the rule laid down by this Court in *Plummer* v. *Coler,* 178 U. S. 115, where it is said (p. 137):

> But when the effort is made, as is the case here, to establish the unconstitutional character of a particular tax by claiming that its remote effect will be to impair the borrowing power of the government, courts in overturning statutes, long established and within the ordinary sphere of state legislation, ought to have something more substantial to act upon than mere conjecture. The injury ought to be obvious and appreciable.

The injury here is certainly not obvious. The borrowing capacity of States, counties and cities has not been curtailed. The estimated amount of securities issued by such bodies had grown by January 1, 1922, to the total of $8,142,000,000, then outstanding. (See *National Life Ins. Co.* v. *United States,* 277 U. S. 508, 532.) This amount equalled approximately one-third of the Federal indebtedness outstanding on June 30, 1921, though that indebtedness embraced the entire war obligations of the Government. (See Annual Report of Secretary of the Treasury for 1921, pages 680 to 685.) But, in spite of this vast amount, the cost to States, counties and cities of borrowed money has remained practically constant in a rising money market. (Grimes & Craigue, Principles of Valuation, 1928, page 204.)

Nor is the injury here appreciable. As this Court said in *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514, 523:

> In a broad sense, the taxing power of either government, even when exercised in a manner admittedly necessary and proper, unavoidably has some effect upon the other. The burden of federal taxation necessarily sets an economic limit to the practical operation of the taxing power of the states, and *vice versa.* Taxation by either the state or the federal government affects in some measure the cost of operation of the other.

When a city sells its bonds, it of course agrees to pay at maturity the principal amount of the bonds and in the meantime a stated interest at stated periods. This is its obligation, and it is admitted that no tax can be imposed which increases that obligation. *Panhandle Oil Co.* v. *Knox,* 277 U. S. 218. Beyond this the obligation of the city does not go. It does not guarantee, or even hold out, a prospective gain or increment in the value of these bonds. It may be that the fact that any gain on a sale of bonds purchased would not be taxable would be attractive to a prospective investor. The possibility theoretically may affect the price, but common experience demonstrates that its influence must be relatively remote. The advantage resulting from the exemption affects directly and immediately only the purchaser. It exists only in prospect. Necessarily its bearing upon the

city's credit is shadowy and of but slight importance.

In the case of *Plummer* v. *Coler, supra,* identical contentions were made as are made here. It was there contended that the tax on inheritance would, by deterring individuals from investing in Federal securities, lessen the demand for such securities; that individuals would be driven to consider, when making their investments, whether they could rely on their heirs and legatees receiving United States bonds unimpaired by State action in the form of taxation; and that, if it should be held that such taxation was lawful, capital would not be invested in United States bonds on terms as favorable as if the Court were to hold the tax invalid. But the court said that the tax was valid, intimating that the supposed burden was "merely fanciful" or certainly no greater than the burden placed upon such securities by State laws taxing franchises of corporations, and held that (p. 136):

> * * * the mischief to our national credit, so feelingly deplored in the briefs, caused by state taxation upon estates of decedents, would be inappreciable, and too remote and uncertain to justify us now in condemning the tax system of the State of New York.

See also *Orr* v. *Gilman,* 183 U. S. 278. Conversely Congress may require that municipal bonds be included in determining the value which is the

measure of the Federal Estate Tax. *Greiner* v. *Lewellyn*, 258 U. S. 384.

There is even a greater degree of remoteness in the instant case than in those above cited. The imposition of an inheritance tax is certain where the decedent owns property, bonds included, sufficient in amount. The imposition of a tax in the situation here presented, however, is contingent upon the possibility that the owner may sell, and the further possibility that he may sell at a profit. Accordingly, it is submitted that the burden here, if any, upon the borrowing power of the State, is too remote to make the tax unconstitutional.

The recent decision of the Circuit Court of Appeals for the Sixth Circuit, in the case of *Nauts* v. *Slayton*, decided December 6, 1929, not yet reported (See Appendix B), foreshadows a possible conflict on the question here involved. In that case, which raised the question of the constitutionality of the disallowance by the Commissioner of Internal Revenue of interest paid by a taxpayer on money which he borrowed to purchase municipal bonds, the court said:

> In arriving at the conclusion indicated we have not been at all influenced by the holding in *Bunn* v. *Willcuts, Collector*, 29 Fed. (2nd) 132, a decision of the District Court of the District of Minnesota, to which the taxpayer has specifically called our attention. In that case there was a holding that not only was the interest from Municipal securities

exempt from Federal taxation, but also that profit made from the purchase and sale of such securities is likewise exempt. Even were we to consider the question as not foreclosed by the holdings of the Supreme Court in *Plummer* v. *Coler,* 178 U. S. 115; *Orr* v. *Gilman,* 183 U. S. 278, it is not now before us. Here no question is raised as to the taxability of profits made in the purchase and sale of Municipal bonds. Such profit was included in gross income, and the tax paid upon it is not herein sought to be recovered.

CONCLUSION

Wherefore, it is respectfully submitted that the petition for a writ of certiorari in this case should be granted.

CHARLES E. HUGHES, JR.,
Solicitor General.

G. A. YOUNGQUIST,
Assistant Attorney General.

SEWALL KEY,
JOHN G. REMEY,
Special Assistants to the Attorney General.

DECEMBER, 1929.

O. D. 647, Cumulative Bulletin No. 3, July–December, 1920, page 123:

> Profit derived from noninterest-bearing State and municipal securities purchased at a discount and held until maturity is not taxable where it clearly appears that the return from the investment in the hands of the taxpayer is due solely to the compensation received from the State or municipality in lieu of interest for the use of the taxpayer's money. In no case may such exemption exceed the total discount at which the securities were originally sold by the State or municipality.

O. D. 737, Cumulative Bulletin No. 3, July–December, 1920, page 49:

> Profit derived from State and municipal securities purchased at a discount is not taxable in the hands of the person holding such obligations at maturity except that in no case may such exemption exceed the total discount at which the securities were originally sold by the State or municipality.
>
> Inasmuch as no person other than the municipality can pay the interest borne by the obligations of the municipality (whether such interest is paid at a specified rate or in the form of realized discount), any person selling municipal bonds for an amount in excess of the cost of the bonds to him (or their fair market value as of March 1, 1913, if they were acquired prior to that date) realizes a taxable profit to the extent of such excess amount even though the bonds were issued at a discount.

O. D. 762, Cumulative Bulletin No. 4, January–June, 1921, page 31:

> The M bank purchased certain 10-year 4½ per cent municipal bonds at 96.10 which had been originally issued and sold by the municipality at 94.50. The question is presented as to whether in case the bank sells the bonds before maturity at 98, the profit realized will be exempt in its hands.
>
> Held, that inasmuch as no person other than the municipality can pay the interest borne by the obligations of the municipality (whether such interest is paid at a specified rate or in the form of realized discount) any person selling municipal bonds for an amount in excess of the cost of the bonds to him realizes a taxable profit to the extent of such excess amount even though the bonds were issued at a discount.
>
> If, therefore, the bank sells at $98 the municipal bonds issued at $94.50 and purchased by it at $96.10 it will derive a taxable profit of $1.90 on each bond sold. If, however, it holds the bonds to maturity and receives $100, the difference between the purchase price of the bonds and the amount received or $3.90 will represent exempt income to it.

Appendix B

No. 5437. United States Circuit Court of Appeals, Sixth Circuit. Charles H. Nauts, collector of internal revenue, appellant, *v.* W. L. Slayton, appellee. Appeal from the United States District Court, Northern District of Ohio, Western Division. Decided December 6, 1929

Before Moorman and Hicks, Circuit Judges, and Simons, District Judge.

SIMONS, District Judge: This action is to determine the applicability of provisions of the Revenue Act of 1921, to admitted facts, and their constitutionality as applied. For convenience plaintiff in the court below, and appellee here, will be referred to as the taxpayer; the defendant below as the collector.

During the year 1922 the taxpayer was engaged in the business of buying, selling and dealing in Municipal bonds. During that year he received as interest from bonds owned by him $65,720.06. During the same period he paid as interest on money borrowed to buy and carry such bonds the sum of $78,153.84. In his return for the year he excluded from his gross income the interest from the bonds, for the reason that such income was exempt. He deducted interest paid during the year and set it off against profit made upon the sale of bonds. Upon audit of his return, the Treasury Department disallowed the deduction of interest paid and assessed additional taxes based upon a recomputation of his income after the disallowance of such deduction. These additional taxes were paid. Claim for refund was duly filed and rejected, and the taxpayer sued for the purpose of recovering the paid additional tax. To the taxpayer's petition the defendant demurred. The Court overruled the demurrer, and upon failure of the collector to plead entered judgment in favor of the taxpayer and as against the collector for the amount claimed. This appeal is taken by the collector to review the judgment.

The Treasury Department in disallowing the taxpayer's deduction of interest paid, and in assessing an additional tax, assumed to act under the authority of Sections 213 and 214, of the Revenue Act of 1921. Section 213, defining gross income, specifically exempts interest upon obligations of a State, Territory, or any political subdivision thereof. Section 214–a provides that in computing net income there shall be allowed as deductions,

> 2. All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities, * * * the interest upon which is wholly exempt from taxation under this little.

The taxpayer bases his right to recovery upon two main contentions. First, that he is not an investor in tax exempt securities, but a dealer; that the section is intended to reach only those who invest in tax exempt securities for the purpose of producing non-taxable income, and that as his primary purpose is to produce taxable income, to wit, the profits made upon the purchase and sale of tax exempt securities, and that as such primary purpose is set up in his petition and admitted by the demurrer, Section 214 a–2 is not applicable to him. Furthermore, that in his case the interest paid ought not to be treated purely as interest, but as one of the legitimate and necessary expenses of doing business, to be deducted from gross income in order to ascertain his net income. Secondly, that if the statute is applicable to him, it is unconstitutional, as imposing a burden upon the obligations and securities of a State or its political subdivision.

The District Judge held that the statute did not apply to admitted facts; that so to apply it would make the enactment unconstitutional, and that it is susceptible to a reasonable construction to avoid unconstitutionality. Were there any ambiguity in the language of the section, such rule of statutory construction might be here considered, but we find none. The terms of the section are plain, and being clear the letter of the law must control. We pass over also without detailed consideration the contention that the interest paid must be treated not as pure interest, but as one of the elements in the cost of doing business. Even were we to consider that there are here present the special circumstances under which interest may be treated as among the "ordinary and necessary expenses" suggested by the Supreme Court in *Anderson* v. *42 Broadway Company*, 239 U. S. 69, it is clear from the circumstances of this particular case that the only interest paid that could be so treated would be the excess of interest paid over the amount of interest received. Manifestly this is not the interest here in question, nor upon the disallowance of which this suit is based. The taxpayer herein is seeking to recover all of the additional tax computed upon the disallowance of a deduction of all of the interest paid.

We come then to the disputed constitutionality of the statute. The taxpayer relies upon and the collector challenges the holding of the Supreme Court in *National Life Insurance Company* v. *United States*, 277 U. S. 508, as authority for the invalidity of the section herein considered. In that case the Court was called upon to deal with Section

245-a of the Revenue Act of 1921. That section provided:

> a—That in case of a life insurance company the term net income means the gross income less—
>
> 1. The amount of interest received during the taxable year which under paragraph (4) of subdivision (c) of Section 213 is exempt from taxation under this title (interest on tax exempt securities);
>
> 2. An amount equal to the excess, if any, over the deductions specified in paragraph (1) of this subdivision of four per centum of the mean of the reserve fund required by law and held at the beginning and end of the taxable year.

The petitioner therein maintained that the result of the collector's action in deducting from the four per cent of the mean of the reserve fund an amount equal to the petitioner's income from tax exempt securities was unlawfully to discriminate against it and really to exact payment on account of its exempt securities, contrary to the Constitution and laws of the United States, and also that diminution of the ordinary deduction of four per cent of the reserve because of interest received from tax exempt securities in effect defeated the exemption guaranteed to their owners. The Court held that one may not be subjected to greater burdens upon his taxable property solely because he owns some that is free. No device or form of words can deprive him of the exemption for which he has lawfully contracted. Also, that the Congress has no power purposely and directly to tax State obligations by refusing to their owners deductions allowed to others.

The collector here seeks to distinguish the situation with respect to tax exempt securities provided for in Section 245 from that in Section 214. He contends that the statute involved in the Insurance Company case gives to all taxpayers exactly the same deduction; that no one is entitled to deduct the interest which he pays to purchase or carry Municipal bonds, and on the other hand, that everyone is entitled to deduct all other interest. In our judgment the situation created by the two sections with respect to the taxation of tax exempt securities is the same, and the applicable principle identical. To deprive the taxpayer of the right to deduct from gross income interest that he has paid during the taxable year because that interest was paid on money borrowed to purchase tax exempt securities is, looking through form to substance, directly to tax the interest of such securities, and so not within the power of Congress to authorize. It is important to note that the Supreme Court in the *National Life Insurance case* considered the deduction of tax exempt interest from the four per cent allowance a direct and purposeful tax upon a State obligation, and did not rely upon any rule to the effect that what Congress may not do directly it cannot do indirectly. This renders unnecessary a consideration of those cases wherein the exercise of the Congressional authority to tax more or less remotely affected the sale of State securities, or remotely or incidentally impaired the borrowing power of the State. Typical of such cases is *Plummer* v. *Coler,* 178 U. S. 115; *Florida* v. *Mellon,* 273 U. S. 12. As we shall see presently, the tax in the instant case is even more obviously a direct tax

upon the income of State obligations than was the tax in the Insurance case.

In the latter it was argued in able dissenting opinions that the four per cent deduction allowed to insurance companies was not given to them as a matter of right; that the allowance of a deduction of four per cent of the mean of the reserve was, as Mr. Justice Brandeis put it, a favor, and as Mr. Justice Stone expressed it, a matter of grace, or a bounty, and in their dissenting opinions (Mr. Justice Holmes concurring with Justice Brandeis), they saw no Constitutional reason why in granting a favor or a bounty the Congress could not lawfully take into consideration an exemption already possessed by the holders of tax exempt securities, every Insurance Company holding such tax exempts being already permitted by the statute to deduct the interest therefrom to the full extent received. In the instant case there is involved no such act of grace on the part of the Congress. There is taken from the taxpayer something which every other taxpayer is allowed, namely the privilege of deducting interest on borrowed money from gross income. It is not a case of making him a gift, and then adjusting the size of the gift to that which he already possesses. To refuse to allow the taxpayer to deduct his interest in effect results in the taxation of something which is not income. We do not here question the power of Congress to make gross income the criterion of a taxpayer's liability, but this it has not done. The settled policy of the Government, in this and other Income Tax Statutes, has been to make net income measure the taxpayer's liability.

In arriving at the conclusion indicated we have not been at all influenced by the holding in *Bunn* v. *Willcuts, Collector,* 29 Fed. (2nd) 132, a decision of the District Court of the District of Minnesota, to which the taxpayer has specifically called our attention. In that case there was a holding that not only was the interest from Municipal securities exempt from Federal taxation, but also that profit made from the purchase and sale of such securities is likewise exempt. Even were we to consider the question as not foreclosed by the holdings of the Supreme Court in *Plummer* v. *Coler,* 178 U. S. 115; *Orr* v. *Gilman,* 183 U. S. 278, it is not now before us. Here no question is raised as to the taxability of profits made in the purchase and sale of Municipal bonds. Such profit was included in gross income, and the tax paid upon it is not herein sought to be recovered. Indeed the petitioner's argument in support of the contention that the statute does not apply to him is founded upon the claim that the primary purpose of his borrowing was to produce taxable income, and not tax exempt income.

In view of Section 1403, of the Act, it is necessary to go no further than did the Court in the National Life Insurance case, and so to hold that the disallowance of interest paid and the additional tax assessed against the taxpayer based upon such disallowance cannot be given effect as against the taxpayer under the circumstances here disclosed. He was lawfully entitled to the judgment obtained in the court below, and

It is hereby affirmed.

U. S. GOVERNMENT PRINTING OFFICE: 1933

FILE COPY

Office Supreme Court
FILED
APR 12 19
CHARLES ELMORE

No. ~~525~~ 22

In the Supreme Court of the United States

OCTOBER TERM, 1929

L. M. WILLCUTS, AS COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MINNESOTA, PETITIONER

v.

CHARLES W. BUNN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE PETITIONER

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	2
Specification of error to be urged	4
Summary of argument	4
Argument	5
Conclusion	15
Appendix	16

CITATIONS

Cases:

Flint v. *Stone Tracy Co.*, 220 U. S. 107 — 11–12, 13
Gillespie v. *Oklahoma*, 257 U. S. 501 — 14
Greiner v. *Lewellyn*, 258 U. S. 384 — 9
Heiner Co. v. *Colonial Trust Co.*, 275 U. S. 232 — 14
Home Insurance Co. v. *New York*, 134 U. S. 594 — 11
Irwin v. *Gavit*, 268 U. S. 161 — 14
Macallen Co. v. *Massachusetts*, 279 U. S. 620 — 13
Metcalf & Eddy v. *Mitchell*, 269 U. S. 514 — 13–14
National Life Insurance Co. v. *United States*, 277 U. S. 508 — 10
Nauts v. *Slayton*, 36 F. (2d) 145 — 10–11
Nicol v. *Ames*, 173 U. S. 509 — 15
Orr v. *Gilman*, 183 U. S. 278 — 9, 10
Plummer v. *Coler*, 178 U. S. 115 — 8, 9, 10, 11, 13
Pollock v. *Farmer's Loan and Trust Co.*, 157 U. S. 429 — 5
St. Louis S. W. Ry. v. *Arkansas*, 235 U. S. 350 — 15
Society for Savings v. *Coite*, 6 Wall. 594 — 11
Stratton's Independence v. *Howbert*, 231 U. S. 399 — 15
Tax Commissioner v. *Putnam*, 227 Mass. 522 — 6
Van Allen v. *The Assessors*, 3 Wall. 573 — 11

Statute:

Revenue Act of 1924, c. 234, 43 Stat. 253, 267 (U. S. C., Title 26, Sec. 954)—
Sec. 213 (a) — 2

Miscellaneous:

Grimes & Craigue, Principles of Valuation, 1928, p. 204 — 10
O. D. 647, Cumulative Bulletin No. 3, July–December, 1920, p. 123 — 7, 16
O. D. 737, Cumulative Bulletin, No. 3, July–December, 1920, p. 49 — 7, 16
O. D. 762, Cumulative Bulletin No. 4, January–June, 1921, p. 31 — 7, 17

106744—30——1

In the Supreme Court of the United States

OCTOBER TERM, 1929

No. 535

L. M. WILLCUTS, AS COLLECTOR OF INTERNAL REVENUE for the District of Minnesota, petitioner

v.

CHARLES W. BUNN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the District Court (R. 4) is reported in 29 F. (2d) 132. The opinion of the Circuit Court of Appeals (R. 15) is reported in 35 F. (2d) 29.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on September 23, 1929. (R. 17.) Petition for certiorari was filed December 23, 1929, and certiorari was granted on January 27, 1930. (R. 18.) The jurisdiction of this Court is based upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Is the imposition of a tax on income including gains derived by the owner of municipal bonds from the sale of such bonds at a profit unconstitutional to the extent of the inclusion of such gains?

STATUTE INVOLVED

Revenue Act of 1924, c. 234, 43 Stat. 253, 267 (U. S. C., Title 26, Sec. 954):

> SEC. 213. For the purposes of this title, except as otherwise provided in section 233—
>
> (a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

While the Treasury Department has promulgated no formal regulations with respect to the inclusion in taxable income of a profit derived from the sale of state and municipal bonds, it has consistently ruled that such profits are taxable. The published rulings on the subject are set out in the Appendix.

STATEMENT

At various dates in the years 1919 and 1920 the respondent purchased for cash as investments cer-

tain bonds issued by various counties and cities in the State of Minnesota. The record does not disclose whether these bonds were purchased from a political subdivision or from some one else, nor does it appear whether the bonds were purchased at, above, or below par. In the month of January, 1924, the respondent sold these bonds and realized upon the whole transaction a net profit (disregarding interest accrued on coupons) of $736.26. He did not include any part of this profit in his income tax return. The Commissioner added this profit (less a net loss of $41.20 suffered by the respondent on certain similar bonds held less than two years) to the respondent's income, and assessed an additional tax of $85.44. This additional tax, together with interest amounting to $14.07, the respondent paid on demand under protest on May 8, 1928. He then filed a claim for refund which was rejected. (R. 2.)

The respondent filed his complaint in the United States District Court for the District of Minnesota (R. 1) and the petitioner demurred. (R. 3.) The District Court overruled the demurrer (R. 4) and, upon failure of the petitioner to answer, entered judgment for the respondent. (R. 8.) From this judgment an appeal was prosecuted to the Circuit Court of Appeals for the Eighth Circuit, which sustained the lower court. (R. 17.) Petition for certiorari was thereupon filed in this Court and certiorari was granted. (R. 18.)

SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred in holding that Congress may not constitutionally impose a tax on income in so far as it includes gains derived by the owner of municipal bonds from the sale of such bonds at a profit.

SUMMARY OF ARGUMENT

The tax in this case, under the administrative construction of the Act by the Treasury Department, is not imposed on municipal bonds, or on the interest paid thereon whether or not in the form of discount, or on any income received pursuant to the bond contract. It subjects to the general provisions of the income tax laws only the gain derived by the owner from the sale of the bonds, over and above interest or discount.

The Circuit Court of Appeals held that such a tax caused an unwarranted burden upon or interference with the exercise by the municipality of its borrowing power upon the theory that the tax would affect the price at which the securities could be marketed. But it is submitted that the decisions of this Court have established the rule that such interference or burden must be obvious, appreciable, and not remote. Taxation has been sustained when imposed upon the transfer of estates, although measured by the value of the estate which included exempt securities. The same rule has been applied to taxes imposed upon the corporate privilege of doing business, although measured by the value of corporate property including exempt securities,

and dividends have been taxed although made up in part of interest from such securities.

The tax on gain derived from a transfer or sale is more remote in relation to the security than a tax on the transfer of a decendent's estate in which the security is included. The contingency of gain is an added condition precedent to the application of the tax.

That the injury is neither obvious nor appreciable is shown by the fact that the cost to states, counties, and municipalities has remained practically constant in a rising money market.

The burden or injury emphasized by the Circuit Court of Appeals is entirely theoretical and no tangible or practical burden has been demonstrated. The decision may be sustained only upon the theory that the United States may impose no tax which may even indirectly give rise to the slightest burden upon the marketing of municipal securities. So stringent a rule is contrary to the principles established by this Court.

ARGUMENT

The precise question presented is the constitutionality of a tax on income to the extent that such income includes gains derived by the owner of municipal bonds from the sale of such bonds.

Admittedly a Federal tax imposed on a municipal bond, or on the interest therefrom, is unconstitutional. *Pollock* v. *Farmers' Loan and Trust Co.*, 157 U. S. 429, 583. But a tax on income including profit derived from the sale of the bond is imposed neither on the bond nor on the interest. The sale of the

bond is a transaction wholly distinct from the contract between the municipality and the bondholder, and the profit or loss resulting from such sale neither increases nor decreases the liability of the municipality upon the bond. The tax upon such profit is not imposed upon the bond or obligation itself, or upon any income received pursuant to the provisions of the bond.

When bonds are sold by a municipality, the price is the then market price. The prospect of profit in excess of the interest or discount is not held out as an inducement. Possible profit from resale, as well as possible loss, depends upon eventualities. It is one of the risks accepted by the owner. The interest on the bond comes to the owner without further effort on his part. It is an exact obligation of the municipality, met with regularity. But gains or losses from sale by the owner result from a combination of factors, including business judgment and sagacity in purchases and sales. The gain, briefly, is derived from a combination of capital, industry, and skill. *Tax Commissioner* v. *Putnam*, 227 Mass. 522, 531. And the tax upon income, including such gain, is not a tax upon any sum received pursuant to the contract provisions of the bond. It is submitted that the use of the general term "income" in certain of the opinions of this Court dealing with the immunity of obligations of the States from taxation by the United States, or *vice versa*, is not controlling on the question of the immunity of the particular sort of "income" represented by such a gain.

The rulings of the Treasury Department set out in the Appendix (O. D. 647, 3 C. B. 123; O. D. 737, 3 C. B. 49; O. D. 762, 4 C. B 31) have consistently held that where a municipality originally issues a bond at a discount and redeems it at par, the return represented by the discount is interest in another form and not taxable, but the exemption has been limited to the amount of the discount, and profit resulting to the holder from a sale has been held taxable.[1]

---

[1] It may be that the rule stated in O. D. 737, 3 C. B. 49, and O. D. 762, 4 C. B. 31, should be subject to some qualification. Since the difference between the amount a municipality receives from the issue of bonds at a discount and the par value paid at maturity is interest in another form, it should be distributed over the term of the bond. For instance, a four per cent bond maturing in five years is issued by a municipality at 95. The true interest rate (leaving aside the determination of present values, etc.) is five per cent. If the original purchaser holds the bond to maturity, he receives only interest and pays no tax. If, after holding the bond a year, at which time it would be worth 96 on the basis on which it was issued, the holder should sell at that price, the increase of one dollar in value would represent earned interest and would not be taxable. If he should sell at 95, he would suffer a loss of one dollar. On the other hand, if he should sell at 97, the profit of one dollar paid him by his purchaser would constitute a gain independent of interest and would be taxable. The tax on such gain is not imposed upon the bond itself or upon the interest or upon any income received under the terms of the contract with the municipality.

Whether the qualification above suggested or the rule as stated in the Office Decisions is the correct solution is immaterial in this case since it does not appear in this case that the bonds were issued at a discount.

106744—30—2

The decision of the Circuit Court of Appeals in the present case held that a tax upon income, to the extent that it included gain from the sale of exempt securities, was an unwarranted interference with and burden upon the exercise by the municipality of the vital function of borrowing money. This conclusion was based upon the premise that the tax would have an economic effect upon the price of such securities. It is submitted that this theory is applicable to the present case only if the United States is restrained by a rule, without exception, to the effect that it can not levy any tax which may, to the slightest perceptible degree, place a burden upon the marketing of municipal securities or to such degree render them less salable.

The case of *Plummer* v. *Coler*, 178 U. S. 115, demonstrates that the rule is by no means so stringent. In that case, this Court considered the question whether, under the inheritance tax laws of a State, a tax may be validly imposed on a legacy consisting of United States bonds issued under a statute declaring them to be exempt from State taxation in any form. The same contentions were there urged on behalf of the taxpayer, to the effect that the tax on inheritance would, by deterring individuals from investing in Federal securities, lessen the demand for such securities; that individuals would be driven to consider, when making their investments, whether they could rely on their heirs and legatees receiving United States bonds unimpaired by State action in the form of taxation; and that, if it should be held

that such taxation was lawful, capital would not be invested in United States bonds on terms as favorable as if the Court were to hold the tax invalid. The Court said (p. 137):

> But when the effort is made, as is the case here, to establish the unconstitutional character of a particular tax by claiming that its remote effect will be to impair the borrowing power of the government, courts in overturning statutes, long established and within the ordinary sphere of state legislation, ought to have something more substantial to act upon than mere conjecture. The injury ought to be obvious and appreciable.

The Court also said (p. 136):

> * * * the mischief to our national credit, so feelingly deplored in the briefs, caused by state taxation upon estates of decedents, would be inappreciable, and too remote and uncertain to justify us now in condemning the tax system of the State of New York.

See also, *Orr* v. *Gilman*, 183 U. S. 278. Conversely, Congress may require that municipal bonds be included in determining the value which is the measure of the Federal Estate Tax. *Greiner* v. *Lewellyn*, 258 U. S. 384.

The relation of the tax to the security in this case is, if anything, more remote than a tax on transfers of decedents' estates measured by a value which includes exempt securities. There the tax upon the transfer is certain if the value of the property reaches the statutory requirements. Here the tax is upon

net income including gain derived from a transfer in the form of a sale, and the contingencies of gain from the sale as well as the fact of net income in a taxable amount are added conditions precedent which render the prospective tax one step more remote.

Moreover, the injury here is neither obvious nor appreciable. The borrowing capacity of states, counties, and cities has not been curtailed. The estimated amount of securities issued by such bodies had grown by January 1, 1922, to the total of $8,142,000,000, then outstanding. (See *National Life Ins. Co.* v. *United States*, 277 U. S. 508, 532.) This amount equalled approximately one-third of the Federal indebtedness outstanding on June 30 1921, though that indebtedness embraced the entire war obligations of the Government. (See Annual Report of Secretary of the Treasury for 1921, pages 680 to 685.) But, in spite of this vast amount, the cost to states, counties, and cities of borrowed money has remained practically constant in a rising money market. (Grimes & Craigue, Principles of Valuation, 1928, p. 204.)

In *Nauts* v. *Slayton* (C. C. A. 6th), 36 F. (2d) 145 (in which the Government has applied for certiorari on another question), the court referred to the present case, and strongly indicated that in its opinion the question here presented is controlled by *Plummer* v. *Coler, supra*, and *Orr* v. *Gilman, supra*. The court said (p. 147):

> In that case [*Bunn* v. *Willcuts*] there was a holding that not only was the interest from

municipal securities exempt from federal taxation, but also that profit made from the purchase and sale of such securities is likewise exempt. Even were we to consider the question as not foreclosed by the holdings of the Supreme Court in *Plummer* v. *Coler*, 178 U. S. 115; *Orr* v. *Gilman*, 183 U. S. 278, it is not now before us.

In *Plummer* v. *Coler*, *supra*, this Court made a survey of decisions, both State and Federal, pertinent to the question under consideration. *Van Allen* v. *The Assessors*, 3 Wall. 573, is referred to with approval (p. 126) to the effect that it was competent for Congress to authorize the States to tax shares of banking corporations without regard to the fact that part or all of the capital of such institutions was invested in national securities which were exempt from taxation by State authorities. Again (pp. 126, 127), reference is made to *Society for Savings* v. *Coite*, 6 Wall. 594, and other cases, in which this Court affirmed the right of the States to impose a tax measured by the aggregate value of property of corporations even if United States bonds were included in such property. The same rule was applied to a tax measured by dividends where such dividends were partly composed of interest on United States bonds owned by the company. (See *Home Insurance Co.* v. *New York*, 134 U. S. 594, fully analyzed in *Plummer* v. *Coler*, *supra*, pp. 127–129.) A number of other cases were analyzed by the Court.

In *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, this Court upheld the validity of a corporation tax

measured by the net income of the corporation which included interest from tax exempt securities. The Court said (p. 163):

> The distinction lies between the attempt to tax the property as such and to measure a legitimate tax upon the privileges involved in the use of such property.

Later the Court said (p. 165):

> It is therefore well settled by the decisions of this court that when the sovereign authority has exercised the right to tax a legitimate subject of taxation as an exercise of a franchise or privilege, it is no objection that the measure of taxation is found in the income produced in part from property which of itself considered is nontaxable. Applying that doctrine to this case, the measure of taxation being the income of the corporation from all sources, as that is but the measure of a privilege tax within the lawful authority of Congress to impose, it is no valid objection that this measure includes, in part at least, property which as such could not be directly taxed. See in this connection *Maine* v. *Grand Trunk Ry. Co.*, 142 U. S. 217, as interpreted in *Galveston, Harrisburg & San Antonio Ry. Co.* v. *Texas*, 210 U. S. 217, 226.

This Court, therefore, has repeatedly refused to declare the tax invalid where it is imposed, not on the securities or the interest therefrom, but upon the right to transfer by bequest, devise, or descent; or upon the right to do business; or upon some other right or privilege relating to a particular use of bonds

not growing out of the terms of the bond itself. Here, again, the tax is not upon the bond or interest, but upon the gain from sale. A tax upon gain derived from a transfer in the form of a sale does not appear to burden the sovereign right of borrowing to a greater degree than a tax upon a transfer by inheritance or a tax measured by net income including income from exempt securities.

The case of *Macallan Co.* v. *Massachusetts*, 279 U. S. 620, is not a limitation upon the principles established in *Plummer* v. *Coler*, *supra*, and *Flint* v. *Stone Tracy Co.*, *supra*. The rule in the *Macallan case* applies only where the real object is to impose a tax on exempt securities, and the taxing authorities make use of the form of a privilege tax merely as a medium to accomplish the ultimate purpose of taxing the exempt property. Here, the tax is levied upon net income generally, and the inclusion of gain from sale of exempt securities is merely incidental to the broader purposes of the law.

In *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, this Court said (p. 523):

> In a broad sense, the taxing power of either government, even when exercised in a manner admittedly necessary and proper, unavoidably has some effect upon the other. The burden of federal taxation necessarily sets an economic limit to the practical operation of the taxing power of the states, and *vice versa*. Taxation by either the state or the federal government affects in some measure the cost of operation of the other.

> But neither government may destroy the other nor curtail in any substantial manner the exercise of its powers. Hence the limitation upon the taxing power of each, so far as it affects the other, must receive a practical construction which permits both to function with the minimum of interference each with the other; and that limitation can not be so varied or extended as seriously to impair either the taxing power of the government imposing the tax (*South Carolina* v. *United States*, 199 U. S. 437, 461; *Flint* v. *Stone Tracy Co.*, *supra*, at 172) or the appropriate exercise of the functions of the government affected by it. *Railroad Co.* v. *Peniston*, *supra* [18 Wall.], 31.

In *Heiner* v. *Colonial Trust Co.*, 275 U. S. 232, this Court considered the question of taxation of income derived by a non-Indian from a lease made to him by a tribe of Indians. The Court held (p. 235) that the exemption accorded to those instruments chosen by the Government to fulfill its duties to its Indian wards, as in *Gillespie* v. *Oklahoma*, 257 U. S. 501, was not available to others dealing with the Indians "merely because the statute, if applied as written, may have some perceptible economic effect on the Indians." Again the distinction is made between a tax on the instrument itself, and a tax which may have an incidental effect upon the Government or its activities.

The broad provisions of the income tax laws were intended to include income generally. *Irwin* v. *Gavit*, 268 U. S. 161, 166. It is clear that Section 213(a) of the Revenue Act of 1924, *supra*, is broad enough

to require gains from the sale of municipal securities to be included in gross income. The provisions of the Constitution will not preclude such tax unless the burden is obvious and appreciable. Every presumption is in favor of the constitutionality of an Act of Congress. *Nicol* v. *Ames*, 173 U. S. 509; *Stratton's Independence* v. *Howbert*, 231 U. S. 399; *St. Louis S. W. Ry.* v. *Arkansas*, 235 U. S. 350, 369.

Here, it is submitted, the burden or injury is so remote that, under the principles already established by this Court, the validity of the tax should be upheld.

CONCLUSION

It is respectfully submitted, for the reasons already assigned, that the Circuit Court of Appeals erred in holding that the tax in question was unconstitutional, and that the decision of that court should therefore be reversed.

WILLIAM D. MITCHELL,
Attorney General.

G. A. YOUNGQUIST,
Assistant Attorney General.

J. LOUIS MONARCH,
MORTON POE FISHER,
Special Assistants to the Attorney General.

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue,

T. H. LEWIS, Jr.,
Special Attorney,
Bureau of Internal Revenue,
Of Counsel.

APRIL, 1930.

APPENDIX

O. D. 647, Cumulative Bulletin No. 3, July-December, 1920, page 123:

> Profit derived from noninterest-bearing State and municipal securities purchased at a discount and held until maturity is not taxable where it clearly appears that the return from the investment in the hands of the taxpayer is due solely to the compensation received from the State or municipality in lieu of interest for the use of the taxpayer's money. In no case may such exemption exceed the total discount at which the securities were originally sold by the State or municipality.

O. D. 737, Cumulative Bulletin No. 3, July–December, 1920, page 49:

> Profit derived from State and municipal securities purchased at a discount is not taxable in the hands of the person holding such obligations at maturity except that in no case may such exemption exceed the total discount at which the securities were originally sold by the State or municipality.
>
> Inasmuch as no person other than the municipality can pay the interest borne by the obligations of the municipality (whether such interest is paid at a specified rate or in the form of realized discount), any person selling municipal bonds for an amount in excess of the cost of the bonds to him (or their fair market value as of March 1, 1913, if they were acquired prior to that date) realizes a taxable profit to the extent of such excess amount even though the bonds were issued at a discount.

O. D. 762, Cumulative Bulletin No. 4, January–June, 1921, page 31:

> The M bank purchased certain 10-year 4½ per cent municipal bonds at 96.10 which had been originally issued and sold by the municipality at 94.50. The question is presented as to whether in case the bank sells the bonds before maturity at 98, the profit realized will be exempt in its hands.
>
> Held, that inasmuch as no person other than the municipality can pay the interest borne by the obligations of the municipality (whether such interest is paid at a specified rate or in the form of realized discount) any person selling municipal bonds for an amount in excess of the cost of the bonds to him realizes a taxable profit to the extent of such excess amount even though the bonds were issued at a discount.
>
> If, therefore, the bank sells at $98 the municipal bonds issued at $94.50 and purchased by it at $96.10 it will derive a taxable profit of $1.90 on each bond sold. If, however, it holds the bonds to maturity and receives $100, the difference between the purchase price of the bonds and the amount received or $3.90 will represent exempt income to it.

U. S. GOVERNMENT PRINTING OFFICE: 1930

FILE COPY

JAN 13 193

CHARLES ELMORE CR

Supreme Court of the United States

October Term, 1929.

No. [illegible] 22

L. M. WILLCUTS, as Collector of Internal Revenue for the District of Minnesota,

Petitioner,

vs.

CHARLES W. BUNN,

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

CHARLES BUNN,
Attorney for Respondent.

INDEX.

Page.

I. The Tax Is On Income from Municipal Securities, and Therefore Unlawful 1

II. The Tax Is a Clear Burden On the States..... 2

TABLE OF CASES.

Page.

Doyle vs. Mitchell Bros. Co., 247 U. S. 179..... 2

Eisner vs. Macomber, 252 U. S. 189 2

Gillespie vs. Oklahoma, 257 U. S. 501 2

Metcalf & Eddy vs. Mitchell, 269 U. S. 514..... 2

Pollock vs. Farmers Loan & Trust Co., 157 U. S. 429, 158 U. S. 601 2

United States vs. Phellis, 257 U. S. 156 2

Weston vs. Charleston, 2 Peters 449 2

Supreme Court of the United States

October Term, 1929.

No. 535.

L. M. WILLCUTS, as Collector of Internal Revenue for the District of Minnesota,

Petitioner,

vs.

CHARLES W. BUNN,

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

Certiorari should be denied, because the decisions below were clearly right.

I.

The Solicitor General's argument assumes that the *Pollock* case and the decisions preceding and following it went no further than to hold *interest* on municipal bonds exempt from federal taxation. But those decisions are not so limited. They

settle that there are certain instrumentalities of governments "so intimately connected with the performance of a duty by one government, that any taxation of it by the other would be such a direct interference with the functions of government itself as to be plainly beyond the taxing power"; that municipal securities are in that class; that "when the instrumentality is of that character, the immunity extends not only to the instrumentality itself, but to income derived from it"; that in such cases the immunity does not depend upon degree of burden, but that "to any extent, however inconsiderable," is unlawful. There is no warrant in the decisions for distinguishing between interest income and any other income.

Weston v. Charleston, 2 Peters 449, at 468.

Pollock v. Farmers Loan & Trust Co., 157 U. S. 429, at 583-6, 601-4, 652, 653; 158 U. S. 601, at 618, 666, 680, 693.

Gillespie v. Oklahoma, 257 U. S. 501.

Metcalf & Eddy v. Mitchell, 269 U. S. 514, at 522, 524.

Eisner v. Macomber, 252 U. S. 189, *United States v. Phellis*, 257 U. S. 156, and *Doyle v. Mitchell Bros. Co.*, 247 U. S. 179, show how increment in value may be treated as income and separated from capital when sale of property is made.

As the Government's attempted tax is laid only on income, the *Pollock* case and the decisions following it seem conclusive.

II.

There is also in this tax a clear burden on the States.

The usual inducements to an investment purchase of securities are two, the direct return in interest or dividends expected, and the hope of profit by increased value of the security itself. In times especially when going interest rates are high fixed income securities (like municipals) are purchased by investors

because they know that as interest rates fall the value of the security itself is certain to increase. Such increase can commonly be realized only by a sale.

In times of normal or low interest rates the bonds which tend to increase in value as maturity approaches are those carrying low interest coupons and selling at a discount. This is an important fact considered by investors universally.

In either case, if the increment in state securities is subject to federal taxation, it forces states and their municipalities either to higher interest coupons or to lower selling prices for their bonds. The burden on them is therefore both certain and direct.

The same rule will of course apply to taxation of Federal securities by States.

CHARLES BUNN,
Attorney for Respondent.

FILE COPY

APR 25 1930

IN THE

Supreme Court of the United States

October Term, 1929.

No. 22

L. M. WILLCUTS, as Collector of Internal Revenue for the District of Minnesota,

Petitioner,

vs.

CHARLES W. BUNN.

Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

BRIEF FOR THE RESPONDENT.

CHARLES BUNN,
1006 Merchants Bank Building,
Saint Paul, Minnesota,
Attorney for Respondent.

April, 1930.

INDEX.

Page.

Statement 1

Summary of Argument 1

Argument:

I. The tax is illegal because it is a direct tax on income derived from municipal securities 2

II. The tax is illegal because it is in fact an appreciable burden upon the borrowing power of the States 6

Conclusion 8

TABLE OF CASES.

Page.

Choctaw Oklahoma & Gulf R. R. v. Harrison, 235 U. S. 292. 3

Eisner v. Macomber, 252 U. S. 189 5

Flint v. Stone Tracy Co., 220 U. S. 107 5

Gillespie v. Oklahoma, 257 U. S. 501 . . . . . 2, 3

Greiner v. Lewellyn, 258 U. S. 384 5

Macallen Co. v. Massachusetts, 279 U. S. 620 6

Manhattan Co. v. Blake, 148 U. S. 412 5

Metcalf & Eddy Co. v. Mitchell, 269 U. S. 514 . . . . . 2, 3

Plumer v. Coler, 178 U. S. 115 5

Pollock v. Farmers Loan & Trust Co., 157 U. S. 429, 158 U. S. 601 . . . . . 3, 4

The Collector v. Day, 11 Wall. 113 2

Van Allen v. The Assessors, 3 Wall. 573 5

Weston v. Charleston, 2 Peters 449 . . . . . 3, 4

OTHER AUTHORITIES.

Act of June 17, 1929, Ch. 26, 46 Stat 7

United States Daily, April 23, 1929 (P. 429 and 435); April 25, 1929 (P. 457) 7

IN THE

Supreme Court of the United States

October Term, 1929.

No. 535

L. M. WILLCUTS, as Collector of Internal Revenue for the District of Minnesota,

Petitioner,

vs.

CHARLES W. BUNN.

Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

BRIEF FOR THE RESPONDENT.

STATEMENT.

The case is accurately stated in the brief for the petitioner.

SUMMARY OF ARGUMENT.

The tax is illegal because:

(1) It is a direct tax upon income derived from municipal securities.

(2) It is in fact an appreciable burden upon the borrowing power of the States.

ARGUMENT.

I.

The Tax Is Illegal Because It Is a Direct Tax On Income Derived from Municipal Securities.

The fundamental basis of the exemption of instrumentalities of States from Federal taxation (and vice-versa) is no doubt still the necessity of self-preservation announced in *Collector vs. Day*, 11 Wallace 113. But this Court has made it clear that there are certain instrumentalities of States so closely connected with their existence as independent governments that *any* tax upon them by the United States is void. In *Metcalf & Eddy vs. Mitchell*, 269 U. S. 514, at 524, the court said:

> "While it is evident that in one aspect the extent of the exemption must finally depend upon the effect of the tax upon the functions of the government alleged to be affected by it, still the nature of the governmental agencies or the mode of their constitution may not be disregarded in passing on the question of tax exemption; for it is obvious that an agency may be of such a character or so intimately connected with the exercise of a power or the performance of a duty by the one government, that any taxation of it by the other would be such a direct interference with the functions of government itself as to be plainly beyond the taxing power."

Where the instrumentality is of this class, exemption does not depend upon degree of burden. In *Gillespie vs. Oklahoma*, 257 U. S. 501, at 505, the court said:

> "The criterion of interference by the States with interstate commerce is one of degree. 'It is well understood that a certain amount of reaction upon and interference with such commerce cannot be avoided if the States are to exist

and make laws. New York, New Haven & Hartford R. R. Co. v. New York, 165 U. S. 628. Diamond Glue Co. v. United States Glue Co., 187 U. S. 611, 616. The rule as to instrumentalities of the United States on the other hand is absolute in form and at least stricter in substance."

"And when the instrumentality is of that character, the immunity extends not only to the instrumentality itself, but to income derived from it."

Metcalf & Eddy vs. Mitchell, 269 U. S. 514, at 522.

"In cases where the principal is absolutely immune from interference an inquiry is allowed into the sources from which net income is derived and if a part of it comes from such a source the tax is *pro tanto* void."

Gillespie vs. Oklahoma, 257 U. S. 501, at 505.

In this class fall municipal securities:

Weston v. Charleston, 2 Peters 449, at 468.

Pollock v. Farmers Loan & Trust Co., 157 U. S. 429, 158 U. S. 601.

Metcalf & Eddy v. Mitchell, 269 U. S. 514, at 522, 524.

This court has not made close distinctions between income generally and the special form of income strictly known as interest. In several cases where the income was held to be exempt it was not interest at all. In *Gillespie v. Oklahoma* the tax was on the income made by a lessee from the operation of a lease. In *Choctaw & Gulf R. R. v. Harrison*, 235 U. S. 292, it was an occupation tax on gross production. And in other cases where the income was strict interest the court has generally rested the exemption on the broader ground, that it was income. *Pollock v. Farmers Loan & Trust Co.*, is of special interest because of the numerous opinions. The exemption of income from municipal securities (in particular, bonds of the

City of New York, see 157 U. S. at 583) is treated at the following pages:

Opinion of the Court, 157 U. S. at 583-586.

Opinion of Mr. Justice Field, 157 U. S. at 601-4.

Dissenting Opinion of Mr. Justice White, 157 U. S. at 652.

Dissenting Opinion of Mr. Justice Harlan, 157 U. S. at 653.

Opinion of the Court on rehearing, 158 U. S. at 618.

Dissenting Opinion of Mr. Justice Harlan on Rehearing, 158 U. S. at 666, 680.

Dissenting Opinion of Mr. Justice Brown on Rehearing, 158 U. S. at 693.

Nor has this Court made close distinctions as to the manner in which income from exempt instrumentalities is made. The principle is not that payments made by the municipality are free from tax because so paid, but that "the right to tax the contract, to any extent, when made must operate upon the power to borrow before it is exercised, and have a sensible influence upon the contract. The extent of this influence *depends upon the will of a distinct government. To any extent*, however inconsiderable, it is a burden on the operations of the government." (*Weston v. Charleston*, 2 Peters 449, at 468.)

It is therefore clearly settled that any direct tax by either government on income from the public securities of the other is prohibited. The remaining question is whether the income in this case was in fact derived from the municipal securities in question or whether it was, as claimed by the petitioner, "derived from a combination of capital, industry and skill".

A case is easy to imagine where profits from dealings in municipal securities would be within that definition. One who makes a business of dealing in securities, buying in large blocks for prompt sale at retail at a profit, may fairly be described as making income not from the securities he deals in, but from

the business he conducts. But that is not this case. Respondent is not a dealer in securities. He bought these bonds for cash, and as investments. He held them for five years (R. 2). It is very difficult in fact to assign the profit which he realized upon the sale to anything except the securities themselves. It was simply a portion of the income which he made by the investment of his capital. In *Eisner v. Macomber*, 252 U. S. 189, at 207, this Court defined "gain derived from capital" as follows:

> "*Not* a gain *accruing* to capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in*, being '*derived*', that is, *received* or *drawn* by the recipient (the taxpayer) for his *separate* use, benefit and disposal; *that is* income derived from property. Nothing else answers the description."

Within that definition, this income was derived from the capital invested in these securities, and not from industry or labor.

The contention that a direct tax on the income from municipal securities is void is not weakened by a demonstration that Federal Estate Tax may be imposed on the transfer of State bonds (*Greiner v. Lewellyn*, 258 U. S. 384), or vice versa (*Plumer v. Coler*, 178 U. S. 115), or that a state may tax bank shares at a value based in part on the bank's holding of Federal securities (*Van Allen v. The Assessors*, 3 Wallace 573), or that Congress may tax banks although part of their deposits are State funds (*Manhattan Co. v. Blake*, 148 U. S. 412), or that a corporation excise tax may be measured by net income which includes interest from tax exempt securities (*Flint v. Stone Tracy Co.*, 220 U. S. 107). In all these cases the tax is on a legitimate and separate subject of taxation, and is not held

improper (subject to the limitation enforced in *Macallen Co. v. Massachusetts,* 279 U. S. 620) because part of the measure of the tax results from property which would be exempt if taxed directly. So no doubt it would be proper to impose an excise tax on the business of dealing in securities, measured by the profits of the business, although some of the securities dealt in were municipals. But that is not this case.

II.

The Tax Is Illegal Because It Is in Fact an Appreciable Burden Upon the Borrowing Power of the States.

It cannot be disputed that the usual inducements to an investment purchase of securities are two, the direct return in dividends or interest expected, and the hope of profit by increased value of the security itself. The second inducement is no doubt most present in the case of common stocks, but that it is absent in the case of fixed income securities is not a safe assumption. The State, like other solvent borrowers, may sell securities either at high coupon rates at par or at a premium, or at low coupon rates at a discount below par. Most private borrowers find it good business to adopt the latter plan. The reason obviously is that the certain increment of value as bonds approach maturity induces lenders to accept a lower direct interest return. Also in a time of generally high interest rates, like 1919 and 1920 when these bonds were bought or like the summer of 1929, fixed interest securities are favored by competent investors because they know that as the going rates of interest decline the value of the security itself is certain to increase. That increment in many cases can only be realized by sale. A tax upon it is a tax on a gain that the investor hopes to make by his investment. Necessarily it tends to com-

pel a higher coupon rate upon State bonds than would otherwise be needed. It is a burden on the State, only one step less direct than a tax on the interest itself.

This was the view of both the Courts below, and was quite recently the view of the Treasury Department as to Federal securities. Upon April 22, 1929, there were introduced in the Senate and House bills identical in form, prepared by the Treasury Department, and recommended by the Secretary to the Congress. Their purpose was to authorize the sale of Treasury bills, non-interest bearing, upon a discount basis. They were explained by a letter of the Secretary, and by a speech of the Under-secretary, Mr. Mills, before the American Institute of Banking (United States Daily, April 23, 1929, page 429, April 25, 1929, page 457). The full text of the bills is given in the issue of April 23, 1929, page 435. They provided in section (b) (italics ours):

> "All certificates of indebtedness and Treasury bills issued hereunder (after the date upon which this subdivision becomes law) shall be exempt, both as to principal and interest, *and any gain from the sale or other disposition thereof shall be exempt*, from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, or by any local taxing authority."

The bills were passed in an amended form. (Act of June 17, 1929, Chapter 26, 46 Stat. —). The words italicized above were omitted, and it was provided that "the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest within the meaning of this subdivision". But the form in which the bills were prepared by the Treasury Department demonstrates its expert view that taxation by the States on the profits made by sale of Federal securities would affect adversely the excellent mar-

ket which such securities command. The burden works both ways, and if this conclusion of the Treasury was right it follows that Federal taxation of gains made on sale of municipal securities is a burden on the States. As such, it is invalid.

CONCLUSION.

It is therefore respectfully submitted that the judgment of the Courts below was right, and should be affirmed.

CHARLES BUNN,
1006 Merchants Bank Building,
Saint Paul, Minnesota,
Attorney for Respondent.

April, 1930.

FILE COPY

JAN 6 1930
CHARLES ELMORE CROPLEY
CLERK

In the

Supreme Court of the United States.

OCTOBER TERM, 1929.

No. 535. 22

WILLCUTTS, Collector of Internal Revenue,

v.

CHARLES W. BUNN.

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*, AND BRIEF IN SUPPORT THEREOF.

JOSEPH E. WARNER,
Attorney General of Massachusetts.
R. AMMI CUTTER,
Assistant Attorney General of Massachusetts.

Of Counsel:

HENRY F. LONG,
Commissioner of Corporations and Taxation of Massachusetts.

ADDISON C. GETCHELL & SON, LAW PRINTERS, BOSTON.

SUBJECT INDEX.

	Page
Reference to report of decision below	3
Statement of the case	3
Grounds upon which leave to file brief as *amicus curiae* is sought	4
Points and authorities	5
I. Gains from the sale of stocks, bonds, and other intangible personal property are derived from the use of business acumen and knowledge of investments. Taxation of such net gains from human endeavor imposes no perceptible burden upon the intangible property sold—even though it consist of tax-exempt bonds	6
II. The implied prohibitions of the Constitution of the United States protect the obligations of one member of our system of dual sovereign governments only from taxation by the other government which burdens directly and substantially the obligations themselves or the interest upon them	9

TABLE OF CASES CITED.

Blodgett v. Silberman, 277 U.S. 1	10
Doyle v. Mitchell Bros. Co., 247 U.S. 179	6, 7
Eisner v. Macomber, 252 U.S. 189	6
Flint v. Stone Tracy Co., 220 U.S. 107	9, 10
Greiner v. Lewellyn, 258 U.S. 384	10
Hamilton Co. v. Massachusetts, 6 Wall. 632	10
Home Insurance Co. v. New York, 134 U.S. 594	10
Lucas v. Howard, U.S. Supr. Ct., Oct. Term, 1929, No. 52	10
Macallen Co. v. Massachusetts, 279 U.S. 620	9, 10
Merchants Loan & Trust Co. v. Smietanka, 255 U.S. 509	7
Metcalf & Eddy v. Mitchell, 269 U.S. 514	10, 11
Miller v. Milwaukee, 272 U.S. 713	9

Page

National Life Insurance Co. v. United States, 277 U.S. 508 9
Plummer v. Coler, 178 U.S. 115 10
Provident Institution v. Massachusetts, 6 Wall. 611 10
Society for Savings v. Coite, 6 Wall. 594 10
Stratton's Independence v. Howbert, 231 U.S. 399 6
Taft v. Bowers, 278 U.S. 470 7
Tax Commissioner v. Putnam, 227 Mass. 522 7, 8

TABLE OF AUTHORITIES CITED.

43 Harvard Law Review, 280 10
Mass. General Laws (1921), c. 62, sec. 5 (*c*) 4
Regulation 8001 of the Department of Corporations and Taxation 5
Regulation 8002 of the Department of Corporations and Taxation 5

In the

Supreme Court of the United States.

OCTOBER TERM, 1929.

No. 535.

WILLCUTTS,
COLLECTOR OF INTERNAL REVENUE,

v.

CHARLES W. BUNN.

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*.

And now come the undersigned, as counsel for the Commonwealth of Massachusetts, and respectfully move for leave of this Honorable Court to file the accompanying brief in the above-entitled case as *amicus curiae*, both upon the petition for *certiorari* and upon the argument of the principal case, if the petition for *certiorari* be granted.

JOSEPH E. WARNER,
Attorney General of Massachusetts.
R. AMMI CUTTER,
Assistant Attorney General of Massachusetts.

Of Counsel:

HENRY F. LONG, Commissioner of Corporations and Taxation of Massachusetts.

In the

Supreme Court of the United States.

OCTOBER TERM, 1929.

No. 535.

WILLCUTTS,
COLLECTOR OF INTERNAL REVENUE,

v.

CHARLES W. BUNN.

BRIEF OF THE COMMONWEALTH OF MASSACHUSETTS AS *AMICUS CURIAE*.

REFERENCE TO REPORT OF DECISION BELOW.

The case below is reported as follows: District Court of the United States for the District of Minnesota (*Cant*, J.), 29 Fed. (2d) 132, *sub nom. Bunn* v. *Willcutts, Collector*, decided November 17, 1928, Circuit Court of Appeals, Eighth Circuit (*Stone, Booth*, and *Gardner*, JJ.), 35 Fed. (2d) 29, decided September 16, 1929.

STATEMENT OF THE CASE.

This was an action (R. 1) by the taxpayer, Mr. *Bunn*, to recover a Federal income tax assessed upon *gains* received by the taxpayer from the *sale* of municipal bonds issued by counties or cities in Minnesota. The Collector

demurred to the petition (R. 3). The demurrer was overruled (29 Fed. (2d) 132, R. 4). The Collector stood upon his demurrer and appealed, and the judgment was affirmed (35 Fed. (2d) 29, R. 14, 17). The government is now petitioning for *certiorari*. The ground of the decisions below was that profits from the sale of state municipal securities are not constitutionally subject to taxation as income by the Federal Government, the courts below taking the view that such taxation would be an impairment of the power of the States and of their subdivisions to borrow money to carry out the powers reserved to them by Article X of the Amendments to the Constitution of the United States. No questions of the taxation of the *principal amount* of state bonds or of *interest* upon state bonds is here involved.

GROUNDS UPON WHICH LEAVE TO FILE BRIEF AS *AMICUS CURIAE* IS SOUGHT.

If the doctrine, announced in its particular application for the first time by the courts below, is sustained, the States will be subjected to the converse of the doctrine—and will be foreclosed from taxing as income profits received by their inhabitants from the sale of Federal securities.

Massachusetts has, since 1916, imposed a tax upon income from the gains from the sale of intangible personal property, including Federal securities.

GENERAL LAWS OF MASSACHUSETTS (1921), c. 62, § 5 (*c*), as amended by ST. 1928, c. 217, § 1:

> "Income of the following classes received by any inhabitant of the commonwealth during the preceding calendar year shall be taxed as follows:
>
> * * * * * * * *
>
> "(*c*) The excess of the gains over the losses received by the taxpayer from purchases or sales of

intangible personal property, whether or not said taxpayer is engaged in the business of dealing in such property, shall be taxed at the rate of three per cent per annum. . . ."

The regulations of the Department of Corporations and Taxation construing said section with respect to so-called "tax exempt" bonds read:

> "8001. The tax of 3 per cent upon the excess of the gains over the losses from purchases or sales of intangible personal property shall be imposed upon the excess of such gains from dealings in stocks, bonds, certificates of indebtedness, notes, bills receivable, 'futures,' 'puts,' 'calls,' 'rights,' and all other classes of intangible personal property.
>
> "8002. The tax upon the excess of gains over losses shall be imposed upon the amount of such excess, irrespective of whether the property involved in such transactions is taxable or non-taxable on its income."

The question of the power of the State to tax the gains received from the sale of Federal Government bonds has not been passed upon by any Massachusetts court. The decision in the case at bar by this Honorable Court will, as a matter of practical fact and of logic and reason, decide the question.

POINTS AND AUTHORITIES.

Massachusetts contends that the decision below was erroneous because—

1. The non-discriminatory taxation of all gains derived from the use of business knowledge and of human ingenuity in dealings in intangible property can have no

material effect to impair the ability of a government to issue its bonds and obligations, even if gains from the sale of such bonds are subjected to the tax.

2. The history of the exemption of state instrumentalities from Federal taxation and of the exemption of Federal instrumentalities from state taxation reveals that the doctrine of exemption has protected governmental obligations only from taxation of the principal amount of such obligations and of the stated interest upon such obligations. This appears not only from the statutes authorizing such tax-exempt obligations, but also from the court decisions construing express and implied constitutional provisions.

I.

GAINS FROM THE SALE OF STOCKS, BONDS, AND OTHER INTANGIBLE PERSONAL PROPERTY ARE DERIVED FROM THE USE OF BUSINESS ACUMEN AND KNOWLEDGE OF INVESTMENTS. TAXATION OF SUCH NET GAINS FROM HUMAN ENDEAVOR IMPOSES NO PERCEPTIBLE BURDEN UPON THE INTANGIBLE PROPERTY SOLD—EVEN THOUGH IT CONSIST OF TAX-EXEMPT BONDS.

The nature of income derived from the sale of property at a profit has been referred to by this court frequently as the gain derived from capital and labor combined.

See, *e.g.*, *Stratton's Independence* v. *Howbert*, 231 U.S. 399, 415;
Doyle v. *Mitchell Bros. Co.*, 247 U.S. 179, 184-185;
Eisner v. *Macomber*, 252 U.S. 189, 207—

where it was said:

> "After examining dictionaries in common use (Bouv. L.D.; Standard Dict.; Webster's Internat. Dict.; Century Dict.), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (*Stratton's Independence* v. *Howbert*, 231 U.S. 399, 415; *Doyle* v. *Mitchell Bros. Co.*, 247 U.S. 179, 185)—'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the *Doyle Case* (pp. 183, 185)."

See also *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U.S. 509, 517-520—

where the use of human ingenuity in obtaining a profit from sales even in isolated transactions was held to produce income.

See *Taft* v. *Bowers*, 278 U.S. 470, 481-482.

That the base of the tax in the case at bar and in cases arising under the Massachusetts Tax Act is the net gain from dealings in intangible personal property can hardly be disputed (see *Merchants Loan & T. Co.* v. *Smietanka*, 255 U.S. 509, 519-520; *Doyle* v. *Mitchell Bros. Co.*, *supra*, at p. 185; see *Tax Commissioner* v. *Putnam*, 227 Mass. 522, 531). What is subjected to tax is the gross amount of profits derived from all the transactions of the taxpayer during the taxable year in intangible property, less all the gross losses suffered by the taxpayer in such dealings during the same period. The base of the tax represents the net product of the ingenuity of the taxpayer in employing his capital in realizing gains from dealings in particular commodities. The commodities themselves

are not by the statute subjected to tax. The distinction between *a tax on intangible property or upon the interest or dividends derived from such property* and *a tax on gains from dealings in such property* was expressed clearly by *Rugg*, C.J., in *Tax Commissioner* v. *Putnam*, 227 Mass. 522, 531:

> "The tax upon interest and dividends is levied upon a return which comes to the owner of the principal security without further effort on his part. The tax upon excess of gains over losses in the purchases and sales of intangible personal property is levied, not upon income derived from a specific property but from the net result of the combination of several factors, including the capital investment and the exercise of good judgment and some measure of business sagacity in making purchases and sales. Gain derived in this way, to express it in 'summary and comprehensive form,' 'is the creation of capital, industry, and skill.' *Wilcox* v. *County Commissioners*, 103 Mass. 544. It is not the production of capital alone and does not arise solely from a simple investment."

It is submitted that to subject to a non-discriminatory tax on income the product of human effort realized in the form of gains upon the sale of so-called "tax exempt" obligations is to impose no substantial or unconstitutional burden upon the obligations themselves, provided no tax is laid upon the principal amount of the obligations or upon the interest paid by the government issuing the obligations.

II.

THE IMPLIED PROHIBITIONS OF THE CONSTITUTION OF THE UNITED STATES PROTECT THE OBLIGATIONS OF ONE MEMBER OF OUR SYSTEM OF DUAL SOVEREIGN GOVERNMENTS ONLY FROM TAXATION BY THE OTHER GOVERNMENT WHICH BURDENS DIRECTLY AND SUBSTANTIALLY THE OBLIGATIONS THEMSELVES OR THE INTEREST UPON THEM.

The freedom of state bonds and the interest upon them from property taxation by the Federal Government and the similar immunity from state taxation enjoyed by Federal bonds and the interest upon them are well settled. Historically, the exemption has been construed by this court principally in cases where the obligations themselves, or the interest payable by the terms of the obligations, were directly submitted to a property tax—

See, *e.g.*, *Miller* v. *Milwaukee*, 272 U.S. 713;
National Life Insurance Co. v. *United States*,
277 U.S. 508, 520—

or to what was construed by this court as having the effect of a direct property tax upon the bonds themselves or the interest upon them.

See, *e.g. Macallen Co.* v. *Massachusetts*, 279 U.S. 620.
Cf. Flint v. *Stone Tracy Co.*, 220 U.S. 107, 162-165.

The bonds of a State or of the Federal Government are not, by reason of their tax-exempt feature, removed

from the possibility of being used as the subject of commercial transactions and of market speculation—in which individuals take advantage of their judgment of economic conditions to obtain a profit by purchasing at a low price and selling at a high (see the ingenious argument 43 *Harvard Law Review*, 280, 284, December, 1929). The fruits of human ingenuity, even when employed in intimate relationship with a state government, are not always exempt from taxation by the Federal Government.

> *Metcalf & Eddy* v. *Mitchell*, 269 U.S. 514.
> *Lucas* v. *Howard*, Supreme Court of the United States, Oct. Term, 1929, No. 52, decided December 9, 1929.

The taxation of gains derived from the sale of exempt bonds—as the product of the joint employment of business judgment and capital—bears, we submit, far less directly upon the principal amount of the bonds than the legacy taxes sustained in *Plummer* v. *Coler*, 178 U.S. 115, and in *Blodgett* v. *Silberman*, 277 U.S. 1, 12, and the estate tax held valid in *Greiner* v. *Lewellyn*, 258 U.S. 384. Excise taxes upon corporations owning exempt bonds are sustained when the burden upon the bonds is incidental and casual—though the bonds add to the value of the privilege taxed.

> *Provident Institution* v. *Massachusetts*, 6 Wall. 611.
> *Hamilton Co.* v. *Massachusetts*, 6 Wall. 632.
> *Society for Savings* v. *Coite*, 6 Wall. 594.
> *Home Insurance Co.* v. *New York*, 134 U.S. 594.
> *Flint* v. *Stone Tracy Co.*, 220 U.S. 107, 162-165.
> *Cf. Macallen Co.* v. *Massachusetts*, 279 U.S. 620, 628.

The tax in the case at bar touches no portion of the taxpayer's investment. It touches no increment of wealth upon that investment to which he became entitled by the terms of the contract contained in the bond he bought. It touches only a profit arising from changed external business circumstances, which the taxpayer has foreseen and of which the taxpayer has taken advantage.

Doubtless there are exemptions and immunities from Federal action which could be added to municipal bonds making those bonds more marketable. However, the necessity that two governments operate within the same geographical area makes it necessary that the exemption granted to the obligations and instrumentalities of one of these governments from taxation by the other be given a practical construction.

> See Mr. Justice *Stone*, speaking for the Court in *Metcalf & Eddy* v. *Mitchell*, 269 U.S. 514, 522-524.

The indefinite and shadowy nature of the casual and indirect burden of the tax involved in the case at bar upon the ability of the subdivisions of States to borrow money should, we submit, lead this court to decide that the tax imposed is not prohibited by any express or implied provision of the Constitution of the United States.

Respectfully submitted,

JOSEPH E. WARNER,
Attorney General of Massachusetts.

R. AMMI CUTTER,
Assistant Attorney General of Massachusetts.

Of Counsel:

HENRY F. LONG, Commissioner of Corporations and Taxation of Massachusetts.

FILE COPY

No. ~~555.~~ 22

Office Supreme Court, U.
FILED
FEB 24 1930
CHARLES ELMORE CROPL
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1929.

L. M. WILLCUTS, as Collector of Internal Revenue for the District of Minnesota, Petitioner,

v.

CHARLES W. BUNN, Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

Motion of the People of the State of New York for Leave to File Brief as Amicus Curiae, and Brief of Amicus Curiae.

HAMILTON WARD,
Attorney General of the State of New York.

HENRY S. MANLEY,
Assistant Attorney General,
Counsel for Amicus Curiae.

BATAVIA TIMES, LAW PRINTERS,
BATAVIA, N. Y.

SUBJECT INDEX.

(PAGE)

Motion for leave to file brief as *amicus curiae* 1

Preliminary Statement, particularly as to State's interest 2

Argument 4

Supererogation 6

TABLE OF CASES CITED.

Ithaca Trust Co. v. United States, 279 U. S. 151 6

Metcalf & Eddy v. Mitchell, 269 U. S. 514 6

No. 535.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1929.

L. M. WILLCUTS, as Collector of Internal Revenue for the District of Minnesota, Petitioner,

v.

CHARLES W. BUNN, Respondent.

Motion for Leave to File Brief as Amicus Curiae.

May it Please the Court:

The undersigned, as counsel for the People of the State of New York, respectfully move this Honorable Court for leave to file the accompanying brief in this case as *amicus curiae*.

HAMILTON WARD,
Attorney General of the State of New York,

HENRY S. MANLEY,
Assistant Attorney General,
Counsel for the State, as Amicus Curiae.

No. 535.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929.

L. M. WILLCUTS, as Collector of Internal Revenue for the District of Minnesota, Petitioner,

v.

CHARLES W. BUNN, Respondent.

BRIEF ON BEHALF OF THE PEOPLE OF THE STATE OF NEW YORK, AMICUS CURIAE.

Preliminary Statement.

OPINIONS BELOW.

The opinion of the District Court (R. 4) is reported in 29 F. (2d) 332. The opinion of the Circuit Court of Appeals for the Eighth Circuit (R. 15) is reported in 35 F. (2d) 29. Certiorari was granted by this court on January 27, 1930.

FACTS.

It appears that the respondent purchased in 1919 and 1920, as investments, certain bonds issued by counties and cities in Minnesota. In 1924 he sold these bonds at a net profit (not including accrued interest).

POSSIBLE INADEQUACIES OF THE RECORD.

The purchase price, the sale price, and the interest rate involved, do not appear. Whether the purchase was from the municipalities, and if so whether by bid, and if by bid whether directed to the purchase price or the interest rate or both, do not appear.

DECISION.

Both courts below decided that the profit involved is not subject to federal tax as income; that it is exempt upon the same constitutional considerations applicable to interest derived from the same bonds.

QUESTION.

Has the tax in question such an appreciable tendency to burden the fiscal operations of the municipalities involved, that it is constitutionally objectionable, in general and without showing more than is shown by the present record?

INTEREST OF THE STATE.

The State deems itself interested to have the question stated above given a negative answer. It does not claim, on behalf of itself or its municipalities, that the tax in question has any appreciable tendency to burden its or their fiscal operations. It does claim that it is embarrassed by certain corollaries of the doctrine expounded by the courts below, as follows: (1) The State has heretofore subjected and is subjecting to its income taxes, profits derived upon sales of federal securities; accordingly it is interested to oppose a determination suggesting the unconstitutionality

of such taxation. (2) All bonds of the State and its municipalities are issued at par or above, and retired at par, due allowance being made for any such difference as a loss deductible under the state income tax law and amortizable under the federal income tax law; accordingly the State is interested to oppose a determination requiring profits to be ignored, and thus logically requiring that losses be ignored.

In the two matters suggested, the State believes that its present rule is a just expression of the principle of income taxation. It will argue below that the record discloses no constitutional exigency to which the principle must be subordinated.

Argument.

Almost all bonds issued by the State of New York and its municipalities, are offered for sale at par, the interest rate to be fixed by competitive bidding. Various provisions of statute law, applicable to the various municipalities, forbid them to sell their bonds for less than par. They can fix an interest rate which will result in bids of par or above, but of late years the almost invariable practice has been to offer at par and let the bidders fix the interest rate. The prospective purchaser who offers to pay par for the bonds, and be content with a specified rate of interest below that specified by any other bidder, buys the issue.

If such a bidder is guided by the present practice and regulations of the federal taxing authorities, he anticipates that any profit derived, or any loss incurred, upon a subsequent resale, will be taken into account in computing his taxable net income for the year of resale.

Will this anticipation have any appreciable tendency to base the offer to the municipality upon an interest rate less attractive to it?

That question is to be answered in the affirmative upon one assumption only: *that profitable resale is the universal motive of bidders.* If there is any participation in the bidding by persons seeking an investment for duration of the issue, and hence representing the ultimate or highest market for bonds, sale will be upon a basis anticipating no resale, profitable or unprofitable. If the contingency of resale is weighed at all by such a bidder, the normal expectation will be of a resale at the original purchase price, a loss perhaps of the costs of handling. The anticipation of taxation based upon the profit derived, or of tax deduction based upon the loss sustained, in a resale viewed merely as a contingency—an incident to investment—will never prejudice the municipality.

There is, of course, the possibility that though the investment bidder will not be directly affected by considerations of taxation, he may be indirectly affected by them. Because another class of bidders—those buying for a profitable resale—may be affected by considerations of taxation, the force of competition bearing upon the investment bidder may be relaxed, to some incalculable degree, and thus his bid may be indirectly affected to the prejudice of a State or municipality. We respectively submit that this possibility is so far conjectural, and so difficult to evaluate, that it need not weigh in the constitutional scale; at least not until complaint is made by a State or municipality and supported by some evidence.

What is said above, if it is true, is sufficient for the present case. The respondent says he bought his bonds for

investment, and he does not say enough else about the facts of his transaction to distinguish it from that stated above.

Supererogation.

The conclusion is not different, in any case where the purchaser buys bonds at par. Although the interest rate was fixed by the State or municipality in advance of bidding, presumably it was fixed at a rate identical with the views of the successful bidder; hence his purchase at par.

A different case is presented when bonds bearing 4% are offered to a market which demands 5%. They will be sold at a discount, and the expected appreciation between then and maturity is in the nature of additional interest. It will be a question of fact in each case, whether an excess over purchase price received upon resale is truly profit, or is appreciation in the nature of interest. If the former, *i. e.*, if it is an amount really representing a difference in notions of value at two different points of time *(Ithaca Trust Co. v. United States,* 279 U. S. 151) then the State or municipality was not prejudiced at the former point of time by the possibility of taxation based upon an unpredictable eventuality. If the latter, *i. e.*, if it is an amount partly or entirely in the nature of interest, we are left with a troublesome question of degree to which the State or municipality has been prejudiced, and there are intimations that here also the facts of the particular case control *(Metcalf & Eddy v. Mitchell,* 269 U. S. 514).

It is our understanding that under the federal income tax, as interpreted in the Regulations and Treasury Department decisions, no tax is imposed upon appreciation in the nature of interest, and that possibility may be disre-

garded for present purposes. (Brief of petitioner, upon application for certiorari, page 7.) Another reason why it may be disregarded is because the present record does not show that the "profit" involved is of such nature.

Respectfully submitted,

HAMILTON WARD,
Attorney General of the State of New York.

Brief by:
HENRY S. MANLEY,
Assistant Attorney General.
Albany, January 28, 1930.

CORRECTED COPY

SUPREME COURT OF THE UNITED STATES.

No. 22.—October Term, 1930.

L. M. Willcuts, as Collector of Internal Revenue for the District of Minnesota, Petitioner,
vs.
Charles W. Bunn.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[January 5, 1931.]

Mr. Chief Justice Hughes delivered the opinion of the Court.

The respondent, Charles W. Bunn, in the years 1919 and 1920 purchased for cash, as investments, bonds issued by various counties and cities in the State of Minnesota. In January, 1924, he sold these bonds, realizing a net profit of $736.26. Upon this net profit, less a net loss of $41.20 suffered by him on similar bonds held less than two years, the Commissioner of Internal Revenue determined an additional income tax in the amount of $85.44. The plaintiff paid this amount to the Collector, under protest, and claimed a refund upon the ground that the tax was illegal because assessed upon income from municipal bonds. The claim was rejected and this suit was brought against the Collector to recover the money paid.

The complaint, alleging these facts, charged that the Revenue Act of 1924, if thus applied, was unconstitutional and void in that the tax was laid upon the instrumentalities of States. Demurrer to the complaint was overruled by the District Court, and, the defendant having declined to plead further, judgment was entered for the plaintiff. The judgment was affirmed by the Circuit Court of Appeals, and this Court granted a writ of certiorari.

The Revenue Act of 1924 (c. 234, sec. 213, 43 Stat. 253, 267, 268, U. S. C. Tit. 26, sec. 954) clearly authorized the tax. The Act included in the term "gross income" the gains and profits derived from "sales, or dealings in property, whether real or per-

sonal." See *Irwin* v. *Gavit*, 268 U. S. 161, 166. The Act gave an express exemption to "interest upon the obligations of a State, Territory or any political subdivision thereof," but this exemption was not extended to profits realized on the sale of such obligations and the statement of the Government is not challenged that it has been the uniform practice of the Treasury Department in administering the federal income tax acts to include in taxable income the gain derived from the sale of state and municipal bonds.

The authority of the Congress to lay a tax on the profit realized by an investor from the sale or conversion of capital assets in general is not open to dispute and is not disputed. That is a matter of governmental policy and not of constitutional power.[1] The question raised here is not because the securities sold were capital assets but because they were governmental in character.

The question is further limited by the fact that it does not appear that the securities were issued at a discount, so that the gain derived could be considered to be in lieu of interest. Whatever questions might arise in cases of that sort are not now before the court.[2] The present case is simply one of profit obtained from purchase and sale, without qualification by any special circumstances.

The well-established principle is invoked that a tax upon the instrumentalities of the States is forbidden by the Federal Constitution, the exemption resting upon necessary implication in order effectively to maintain our dual system of government.[3] The familiar aphorism is "that as the means and instrumentali-

[1]Merchants' Loan and Trust Co. *v.* Smietanka, 255 U. S. 509, 519, 520; Goodrich *v.* Edwards, 255 U. S. 527; Walsh *v.* Brewster, 255 U. S. 536.

[2]It appears that the Treasury Department has ruled that where a municipality originally issues a bond at a discount and redeems it at par, the return represented by the discount is interest in another form and is not taxable. See O. D. 647, Cumulative Bulletin No. 3, July-December, 1920, p. 123; O. D. 737, *id.* p. 49; O. D. 762, Cumulative Bulletin No. 4, January-June, 1921, p. 31.

[3]Collector *v.* Day, 11 Wall. 113, 127; United States *v.* Railroad Company, 17 Wall. 322, 327; Mercantile Bank *v.* New York, 121 U. S. 138, 162; Pollock *v.* Farmers' Loan & Trust Company, 157 U. S. 429, 584-586; *id.*, 158 U. S. 601, 618; Ambrosini *v.* United States, 187 U. S. 1, 17; Metcalf & Eddy *v.* Mitchell, 269 U. S. 514, 523; National Life Insurance Company *v.* United States, 277 U. S. 508, 521.

ties employed by the General Government to carry into operation the powers granted to it are exempt from taxation by the States, so are those of the States exempt from taxation by the General Government." *Ambrosini* v. *United States*, 187 U. S. 1, 7. And a tax upon the obligations of a State or of its political subdivisions falls within the constitutional prohibition as a tax upon the exercise of the borrowing power of the State. *Pollock* v. *Farmers' Loan & Trust Company*, 157 U. S. 429, 584-586; *id.*, 158 U. S. 601, 618; *National Life Insurance Company* v. *United States*, 277 U. S. 508, 521.

The limitation of this principle to its appropriate applications is also important to the successful working of our governmental system. The power to tax is no less essential than the power to borrow money, and, in preserving the latter, it is not necessary to cripple the former by extending the constitutional exemption from taxation to those subjects which fall within the general application of non-discriminatory laws, and where no direct burden is laid upon the governmental instrumentality, and there is only a remote, if any, influence upon the exercise of the functions of government. This distinction has had abundant illustration. Thus, while the salary of an officer of the State cannot be taxed by the Federal Government, the compensation paid by a State or a municipality to a consulting engineer, who is neither an officer nor an employee of government, for work on public projects, may be subjected to a federal income tax. *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 524. No constitutional implications prohibit a non-discriminatory tax upon the property of an agent of government merely because it is the property of such an agent and used in the conduct of the agent's operations and necessary for the agency. *M'Culloch* v. *Maryland*, 4 Wheat. 316, 436; *Railroad Company* v. *Peniston*, 18 Wall. 5, 33; *Central Pacific Railroad Company* v. *California*, 162 U. S. 91, 126; *Baltimore Shipbuilding Company* v. *Baltimore*, 195 U. S. 375, 382; *Choctaw, Oklahoma & Gulf Railroad Company* v. *Mackey*, 256 U. S. 531, 537. The Congress may tax state banks upon the average amount of their deposits, although deposits of state funds by state officers are included. *Manhattan Company* v. *Blake*, 148 U. S. 412. Both the Congress and the States have the power to tax transfers or successions in case of death, and this power extends to the taxation by a State of bequests to the United States, and to the

taxation by the Congress of bequests to States or their municipalities. *United States* v. *Perkins*, 163 U. S. 625; *Snyder* v. *Bettman*, 190 U. S. 249, 253, 254.

In the case of the obligations of a State or of its political subdivisions, the subject held to be exempt from federal taxation is the principal and interest of the obligations. *Pollock* v. *Farmers' Loan & Trust Company, supra.* These obligations constitute the contract made by the State, or by its political agency pursuant to its authority, and a tax upon the amounts payable by the terms of the contract has therefore been regarded as bearing directly upon the exercise of the borrowing power of the government. In *Weston* v. *Charleston*, 2 Pet. 449, 468, 469, where the tax, laid under an ordinance of the city council upon United States stock which had been issued for loans made to the United States, was held invalid, the principle was thus stated by Chief Justice Marshall: "The right to tax the contract to any extent, when made, must operate upon the power to borrow before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government. To any extent, however inconsiderable, it is a burthen on the operations of government. . . . The tax on government stock is thought by this Court to be a tax on the contract, a tax on the power to borrow money on the credit of the United States, and consequently to be repugnant to the constitution". This language was applied by the Court in *Pollock* v. *Farmers' Loan & Trust Company, supra* (157 U. S. at p. 586) in holding invalid federal taxation "on the interest" from municipal securities.

But it does not follow, because a tax on the interest payable on state and municipal bonds is a tax on the bonds and therefore forbidden, that the Congress cannot impose a non-discriminatory excise tax upon the profits derived from the sale of such bonds. The sale of the bonds by their owners, after they have been issued by the State or municipality, is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds. Because the tax in question is described as an "income tax" and the profits on sales are included in "income", the distinction is not lost between the nature of a tax applied to interest and that of a tax applied to gains

from sales. The federal income tax acts cover taxes of different sorts. *Brushaber* v. *Union Pacific Railroad Company*, 240 U. S. 1, 17; *Stanton* v. *Baltic Mining Company*, 240 U. S. 103, 114. The tax upon interest is levied upon the return which comes to the owner of the security according to the provisions of the obligation and without any further transaction on his part. The tax falls upon the owner by virtue of the mere fact of ownership, regardless of use or disposition of the security. The tax upon profits made upon purchases and sales is an excise upon the result of the combination of several factors, including capital investment and, quite generally, some measure of sagacity; the gain may be regarded as "the creation of capital, industry and skill." *Tax Commissioner* v. *Putnam*, 227 Mass. 522, 531.

The tax not being on the obligations of the State or municipality, or on the investment therein, as such, the question is whether the tax must nevertheless be held to be invalid because sales by investors are to be deemed inseparably connected with the exercise of the borrowing power of the State. When the Constitution prohibits States from laying duties on imports, the prohibition not only extends to a tax upon the act of importing, but also to one upon the occupation of the importer or upon the articles imported. A tax on the sale of an article, imported only for sale, is a tax on the article itself. *Brown* v. *Maryland*, 12 Wheat. 419, 444. Similarly, with respect to federal taxation of articles exported from any State, the constitutional inhibition gives immunity to the process of exportation and to the transactions and documents embraced in that process. *Fairbank* v. *United States*, 181 U. S. 283; *United States* v. *Hvoslef*, 237 U. S. 1; *Thames & Mersey Marine Insurance Company* v. *United States*, 237 U. S. 19. Only on that construction can the constitutional safeguard be maintained. Again, when the United States has assumed duties with respect to Indian lands, a State cannot impose an occupation or privilege tax on operations conducted in or upon such lands by lessees who have been constituted federal instrumentalities for the purpose of discharging the Government's obligation, *Choctaw, Oklahoma & Gulf Railroad Company* v. *Harrison*, 235 U. S. 292, 298, or upon the leases themselves or capital stock representing them, *Indian Territory Illuminating Oil Company* v. *Oklahoma*, 240 U. S. 522, 530, or upon the net income of such a lessee, *Gillespie* v. *Oklahoma*, 257 U. S. 501,

504. See, also, *Jaybird Mining Company* v. *Weir*, 271 U. S. 609, 612[4]. These cases are not analogous to the one under consideration. If the tax now in question is to be condemned, it must be because of practical consequences and not because purchases and sales by private owners of state and municipal bonds are a part of the State's action in borrowing money. It would be far-fetched to say that such purchases and sales are instrumentalities of the State. They are not transactions made directly or indirectly in behalf of the State or in the course of the performance of any duty of the State. Sales are merely methods of transferring title to the obligation, that is, the right to receive performance of the promise of the State or municipality.

That a transfer of government bonds is not inseparably connected with the exercise of the Government's borrowing power so as to make the transfer *per se* immune from taxation is clearly demonstrated by the decisions upholding non-discriminatory taxation laid upon the transmission of such securities upon the death of the owner. This Court has decided that a State may lay a transfer tax upon a legacy although it consists entirely of bonds of the United States, *Plummer* v. *Coler*, 178 U. S. 115, and that the Congress may tax the transfer of the net assets of a decedent's estate although municipal bonds are included in determining the net value, *Greiner* v. *Lewellyn*, 258 U. S. 384. In *Plummer* v. *Coler*, *supra* (p. 125), the tax of the State was sustained, despite the provision of the Act of Congress under which the bonds were issued that they should be exempt "from taxation in any form by or under State, municipal, or local authority". *id.*, pp. 134, 135; Act of July 14, 1870, c. 256, sec. 1, 16 Stat. 272; Rev. Stat. sec. 3701; U. S. C. Tit. 31, sec. 742. See, also *Orr* v. *Gilman*, 183 U. S. 278, 289; *Blodgett* v. *Silberman*, 277 U. S. 1, 12, 13. And in *Greiner* v. *Lewellyn*, *supra* (p. 387), the Court said that "the estate tax . . . like the earlier legacy or succession tax, is a duty or excise, and not a direct tax like that on income from municipal bonds. *Pollock* v. *Farmers' Loan & Trust Company*, *supra*. . . . Municipal bonds of a State stand in this respect in no different position from money payable to it. The transfer upon death is taxable, what-

[4]Compare McCurdy v. United States, 246 U. S. 263; Shaw v. Gibson-Zahniser Oil Corporation, 276 U. S. 574, 578, 579.

soever the character of the property transferred and to whomsoever the transfer is made. It follows that in determining the amount of decedent's net estate municipal bonds were properly included." On similar grounds, as the Federal Government has power to tax transfers of property by gift *inter vivos*, *Bromley* v. *McCaughn*, 280 U. S. 124, there would seem to be no question of its constitutional authority to include in such taxation gifts of state or municipal securities.

It is urged however, that a federal tax on the profits of sales of such securities should be deemed, as a practical matter, to lay such a burden on the exercise of the State's borrowing power as to make it necessary to deny to the Federal Government the constitutional authority to impose the tax. No facts as to actual consequences are brought to our attention, either by the record or by argument, showing that the inclusion in the federal tax of profits on sales of state and municipal bonds casts any appreciable burden on the States' borrowing power. We are left to the inadequate guidance of judicial notice. It may be considered to be a matter of common knowledge that the bonds of States and their municipalities are for the most part purchased for investment. But while, in the language of the tax act regarding deductions for losses, the purchase of municipal bonds for investment, as in the case of other investments, may be regarded as "entered into for profit" as distinguished from mere personal use, it may be doubted whether the prospect on the part of the ordinary investor of obtaining profit on the resale of such obligations is so important an element in inducing their acquisition that a federal tax laid on such profits, in common with profits derived from the sales of other property, constitutes any substantial interference with the functions of state governments. While the tax is laid on gains, there is also a deduction for losses on sales, and whether investors in such securities would consider it an advantage if both provisions were eliminated is a matter of mere speculation. It must be remembered that we are dealing, not with any express constitutional restriction, but only with an asserted implication. The constitutional provisions authorizing the Congress to lay taxes (Article I, Section 8; Sixteenth Amendment) are certainly broad enough to cover the tax in question, and before we can restrict their application upon the ground of a burden cast upon the State's borrowing

power, where the tax is not laid upon the contracts made by the State in the exercise of that power, or upon the amounts payable thereunder, but is laid upon the result of distinct transactions by private owners, it must clearly appear that a substantial burden upon the borrowing power of the State would actually be imposed. But we have nothing but assertion and conjecture. The assertion might as easily be made as to the necessity of the complete immunity of such securities from federal taxation in the case of estate taxes, and, if mere conjecture were sufficient as to the possibility of a burden being cast by the tax on the essential authority of the State, it could be as readily entertained in the one case as in the other. Indeed, the existence of the illegal burden might be more easily assumed in the case of the estate tax, where the entire value of the securities, and not merely gains on sales, are taken into the reckoning in determining the amount of the tax.

There is, however, an outstanding fact, more important than any possible conjecture. That fact is found in uniform and long-established practice. This practice clearly indicates that neither the Federal Government nor the States have found a tax on the profits of the sales of their securities to be a burden on their power to borrow money. So far as we are advised, the Federal Government has not at any time deemed it to be necessary to exempt from taxation the profits realized by owners on the sale of its obligations, with the exception, recently made, of short-term Treasury bills issued on a discount basis and payable without interest.[5]

[5]In Gray *v.* Darlington, 15 Wall. 63, where the question related to the federal tax under the Act of March 2, 1867, 14 Stat. 477, 478, upon the profits on the sale of bonds of the United States, the point of the decision was that the statute applied only to *annual* "gains, profits and income" and did not extend to the increase in value of the bonds which had taken place in several prior years and was realized in the preceding year. But it was not questioned that annual gains or profits on the sale of government bonds were taxed by the Act. See Hays *v.* Gauley Mountain Coal Co., 247 U. S. 189, 191.

In O. D. 729, Cumulative Bulletin No. 3, July-December, 1920, pp. 123, 124, the Treasury Department ruled: "In the case of Treasury certificates of indebtedness which are offered by the Government at par and accrued interest and not at a discount, only the coupon interest can be considered exempt from normal tax, and from surtax to the extent provided by the act approved September 24, 1917. Where such certificates are subsequently purchased at a discount, the difference between the purchase price and the par value of the

Such profits are included in the general phrase "gains, profits and income" from "sales, or dealings in property," in the Act under consideration. And we understand that under all federal income tax acts, these or similar words have been construed invariably by the administrative authorities as including profits derived from the sale of state and municipal bonds. The present case appears to be the first in which the tax in this respect has been assailed. No State has ever appeared at the Bar of this Court to complain of this federal tax, and it is not without significance that in the pres-

---

certificates received at maturity is profit subject to both normal tax and surtax. The subscriber for Treasury certificates who sells them at a discount sustains a deductible loss, which is the difference between the par value of the certificates and the selling price. Any gain or loss on the sale of Treasury certificates of indebtedness prior to maturity should be determined in accordance with section 202 of the Revenue Act of 1918."

In the 71st Congress, 1st session, an amendment was proposed to section 5 of the Second Liberty Bond Act as amended (40 Stat. 290, U. S. C., Tit. 31, sec. 754), providing for the issue of Treasury bills "on a discount basis and payable at maturity without interest" and that (subdivision (b)) all certificates of indebtedness and treasury bills issued thereunder ~~should be exempt~~ "both as to principal and interest, *and any gain from the sale or other disposition thereof shall be exempt* from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, or by any local taxing authority; *and no loss from the sale or other disposition thereof shall be allowed as a deduction, or otherwise recognized, for the purposes of any tax now or hereafter imposed by the United States or any of its possessions.*". H. R. 1648, 71st Cong., 1st sess. The committee reports in the Senate and House of Representatives state that the amendment, in relation to both certificates of indebtedness and the new Treasury bills, "provides that gain from the sale of either shall be tax exempt, with the necessary supplementary provision that any loss shall not be recognized. Inasmuch as these are short-term obligations, any advance in price will as a practical matter represent nothing more than interest." 71st Cong., 1st sess., H. R. Rep. No. 13, Sen. Rep. No. 9. The words above italicized were, however, omitted in the act as passed. Act of June 17, 1929, c. 26, 46 Stat. 19, 20. By Act of June 7, 1930 (c. 512, 46 Stat. 775), a similar provision as to tax on profits on sales, but limited to the short-term Treasury bills issued at a discount, was enacted. The committee report in the House of Representatives stated that the reason for this enactment was found in the special nature of such Treasury bills. 71st Cong., 2d sess., H. R. Rep. Nos. 1609 and 1759. Aside from these Treasury bills, the federal tax on profits on sales of federal securities has not been changed.

ent instance the States of New York and Massachusetts do appear here as *amici curiae* in defense of the tax.[6]

The history of income tax legislation is persuasive, if not controlling, upon the question of practical effect. *Plummer* v. *Coler*, *supra*, (p. 137, 138). Before the power of the Congress to lay the excise tax in question can be denied in the view that it imposes a burden upon the States' borrowing power, it must appear that the burden is real, not imaginary; substantial, not negligible. We find no basis for that conclusion, or any warrant for implying a constitutional restriction to defeat the tax.

Judgment reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

---

[6]Undoubtedly each of these States has in view the circumstance that it subjects to its own income taxation the gains derived from the sale of federal securities, and it does not desire, in the absence of an applicable legislative restriction, to be deprived of that source of revenue as a corollary of a decision against the power of the Federal Government to tax the gains derived from the sale of state securities. The State of New York disavows any claim that "the tax in question has any appreciable tendency to burden its fiscal operations" or those of its municipalities. The State of Massachusetts contends that: "1. The non-discriminatory taxation of all gains derived from the use of business knowledge and of human ingenuity in dealings in intangible property can have no material effect to impair the ability of a government to issue its bonds and obligations, even if gains from the sale of such bonds are subjected to the tax. 2. The history of the exemption of state instrumentalities from Federal taxation and of the exemption of Federal instrumentalities from state taxation reveals that the doctrine of exemption has protected governmental obligations only from taxation of the principal amount of such obligations and of the stated interest upon such obligations."